



# Iran's Economic Conditions: U.S. Policy Issues

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## Summary

The Islamic Republic of Iran, a resource-rich and labor-rich country in the Middle East, is a central focus of U.S. national security policy. The United States asserts that Iran is a state sponsor of terrorism and that Iran's uranium enrichment activities are for the development of nuclear weapons. To the extent that U.S. sanctions and other efforts to change Iranian state policy target aspects of Iran's economy as a means of influence, it is important to evaluate Iran's economic structure, strengths, and vulnerabilities.

Since 2000, Iran has enjoyed broad-based economic growth. However, strong economic performance has been hindered by high levels of inflation and unemployment and low levels of foreign investment. Some contend that President Ahmadinejad's expansionary monetary and fiscal policies have worsened unemployment, inflation, and poverty in Iran. With the onset of the global economic downturn, Iran's economic growth was expected to slow in 2009 and through 2010.

Iran has long been subject to U.S. economic sanctions, and more recently, to United Nations sanctions, over its uranium enrichment program and purported support for terror activities. Such sanctions are believed by some analysts to contribute to Iran's growing international trade and financial isolation.

Iran's economy is highly dependent on the production and export of crude oil to finance government spending, and consequently is vulnerable to fluctuations in international oil prices. Although Iran has vast petroleum reserves, the country lacks adequate refining capacity and imports gasoline to meet domestic energy needs. Iran is seeking foreign investment to develop its petroleum sector. While some deals have been finalized, reputational and financial risks may have limited other foreign companies' willingness to finalize deals.

While Iran-U.S. economic relations are limited, the United States has a key interest in Iran's relations with other countries. As some European countries have curbed trade and investment dealings with Iran, other countries, such as China and Russia, have emerged as increasingly important economic partners. Iran also has focused more heavily on regional trade opportunities, such as with the United Arab Emirates.

High oil prices have increased Iran's leverage in dealing with international issues, but the country's dependence on oil and other weak spots in the economy have to come to light by the 2008 international financial crisis, which may portend a slowing down of Iran's economy.

Members of Congress are divided about the proper course of action in respect to Iran. Some advocate a hard line, while others contend that sanctions are ineffective at promoting policy change in Iran and hurt the U.S. economy. In the 110<sup>th</sup> Congress, several bills were introduced that reflect both perspectives. Policies toward Iran remain a key issue for the 111<sup>th</sup> Congress.

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## Recent Developments

- The downward pressure on international oil prices associated with the global economic downturn has highlighted vulnerabilities in Iran's economy.
- Due to Iran's isolation from the international financial system, the country has been relatively insulated from negative spillovers from the international financial crisis. However, Iran's ability to access financing for trade and investment, already complicated by foreign and domestic businesses' concerns about Iran's relationship with the international community, have been constrained further by the decline in international credit markets.
- Economic discontent was a major factor in voting decisions in the presidential elections in June 2009. Protests and continued political unrest stemming from the presidential elections have raised questions about the future of President Ahmadinejad's economic policies. Some analysts speculate that Ahmadinejad may try to enact more populist policies in an effort to cement his political base.
- In January 2010, the Iranian parliament approved a subsidy reform plan that would cut government subsidies on fuel and other goods and services. Implementation of the plan may enhance Iran's long-term financial sustainability, but there are concerns that a reduction in subsidies will lead to high rates of inflation and political unrest in the short-term.
- A number of international oil companies have recently announced that they would curb gasoline sales to Iran. They include the Swiss-based Vitol, Glencore, and Trafigura; Royal Dutch Shell; India's Reliance; Malaysia's Petronas; and Russia's LUKOIL.
- The House-passed and Senate-passed versions of H.R. 2194 would impose more punitive sanctions on Iran. The bills would impose penalties on companies that supply Iran with gasoline or support its domestic petroleum-related industries.

## Introduction

The Islamic Republic of Iran is a central focus of U.S. national security policy. The United States has designated the Iranian government as a state sponsor of terrorism. The United States contends that Iran is a destabilizing force in the Middle East and expresses concern about its growing influence in the region and internationally. The United States has decried Iran's uranium enrichment activities, which allegedly are being used to develop nuclear weapons. Iran also has been accused of arming Shiite militias in Iraq, providing support to Hezbollah and Hamas, and inflaming sectarian strife in the Middle East.

This report provides a general overview of Iran's economy, addresses related U.S. policy concerns, and discusses policy options for Congress. The purpose of this report is two-fold. First, it provides insight into important macroeconomic trends, policy reforms and objectives, key economic sectors, international trade patterns, and sources of foreign exchange.<sup>1</sup> Second, in the

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<sup>1</sup> Economic data for this report are drawn from data from the International Monetary Fund (IMF). As a member of the IMF, Iran reports on its economy to the IMF. The economic data are limited in their means of independent verification (continued...)

context of U.S. economic sanctions imposed for national security and foreign policy reasons, the report evaluates Iran's economic structure, strengths, and vulnerabilities and discusses issues and options for Congress.

**Table 1. Iran Country Overview**

Indicator	Description
Land Area	1.6 million square kilometers (slightly smaller than Alaska)
Population	66.4 million (July 2009 estimate)
Median Age	27 years (July 2008 estimate)
Head of State	Mahmoud Ahmadinejad, President since August 2005
Capital	Tehran
Life Expectancy at Birth	71.14 years (2009 estimate)
Gross Domestic Product (GDP) at Price Purchasing Parity	\$876 billion (2009 estimate)
GDP Real Growth Rate	2.6% (2009 estimate)
GDP Per Capita	\$12,900 (2009 estimate)
GDP Composition by Sector (Current Prices)	Industry, 45.2%; services, 43.9%; agriculture, 10.9% (2009 estimate)
Unemployment Rate	11.8%, reported by Iranian government (2009 estimate)
Population Below Poverty Line	18% (2007 estimate)
Inflation Rate (Consumer Prices)	16.8% (2009 estimate)
Exports	\$70.16 billion (2009 estimate)
Export Commodities	Petroleum, chemical and petrochemical products, fruits and nuts, carpets
Imports	\$57.16 billion (2009 estimate)
Import Commodities	Industrial raw materials and intermediate goods, capital goods, foodstuff and other consumer goods, technical services

**Sources:** Central Intelligence Agency (CIA) Factbook; IMF, Direction of Trade Statistics

**Note:** The Iranian fiscal year runs from March 21<sup>st</sup> to March 20<sup>th</sup>.

Iran boasts the world's third largest petroleum reserves, following Saudi Arabia and Canada, and the second largest gas reserves, after Russia. Iran also has the Middle East and North Africa region's second largest economy, after Saudi Arabia, and the second largest population, after Egypt (see **Table 1**). Nevertheless, Iran faces a number of significant economic challenges. Internal challenges include the large role of oil export revenues in financing government spending and vulnerability to oil price fluctuations; dependence on gasoline imports to meet domestic energy needs; high inflation, unemployment levels, and poverty levels; reported domestic economic mismanagement; and widespread economic inefficiency. External challenges include

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(...continued)

by the IMF. In addition, this report relies on data from the Economist Intelligence Unit (EIU) and Global Insights, international economic research and forecasting agencies. U.S. government sources of data include the Central Intelligence Agency for general economic indicators and the Census Bureau for trade data.

U.S. and United Nations (U.N.) sanctions, other forms of U.S.-led financial pressure, and the fallout from the recent global economic turndown.

## Historical Context

The 1979 Islamic revolution changed Iran's modern political and economic history. Ayatollah Ruhollah Khomeini and his supporters transformed Iran into an Islamic state with a public sector-dominated economy that was increasingly internationally isolated. With the Iran-Iraq war (1980-1988), Iran faced negative rates of real economic growth, declines in oil production and revenue, and high levels of inflation. This represented a reversal of economic prosperity in 1960s and 1970s, during which Iran's economy experienced real economic growth rates nearing 10%, one of the world's highest, along with growth in per capita income and low inflation levels.<sup>2</sup>

During the 1990s, Iran strived to rebuild war-torn local production, attract international investment, enhance foreign relations, liberalize trade, and, more recently, redistribute wealth under a series of a five-year economic plans. Post-war economic growth included recovery in oil output, but the country faced a severe economic downturn in the latter part of the decade due to a drop in international oil prices.<sup>3</sup>

Since the 1979 U.S. embassy hostage crisis in Tehran, Iran has been subject to various U.S. economic sanctions. Such actions have been motivated over time by concerns regarding Iran's nuclear program and support for terrorist organizations. More recently, the United States has focused on targeted financial measures to isolate Iran from the U.S. financial and commercial system. Sanctions have been imposed in order to change the Iranian government's policies with respect to its nuclear program and support to terrorist organizations. To that end, the United States has imposed sanctions to curtail the development of Iran's petroleum sector and constrain Iran's financial resources in a way that motivates policy change in Iran. The United States also has applied diplomatic pressure on foreign countries and companies to limit business with Iran.<sup>4</sup> Some European Union states and other countries also have imposed sanctions on Iran in line with moves by the United Nations (U.N.).

The United States has pushed for stronger international sanctions against Iran in the United Nations. Most recently, in March 2008, the United Nations Security Council (UNSC) passed a third round of sanctions against Iran through Resolution 1803, calling for the inspection of suspicious international shipping to and from Iran that are suspected of carrying prohibited goods. It encourages greater monitoring of named Iranian financial institutions, travel bans for named Iranians, and freezes of additional assets related to Iran's nuclear program.

In June 2008, the five permanent members of the UNSC (Britain, China, France, Russia, and the United States) and Germany offered to suspend further sanctions against Iran if Iran agreed to halt its uranium enrichment program and to begin negotiations on constraints of its nuclear activity.<sup>5</sup>

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<sup>2</sup> Abdelali Jbili, Vitali Kramarenko, and José Bailén, "Islamic Republic of Iran: Managing the Transition to a Market Economy," IMF, 2007, pp.1-5.

<sup>3</sup> Ibid.

<sup>4</sup> For more information on U.S. sanctions against Iran, see CRS Report RL32048, *Iran: U.S. Concerns and Policy Responses*, by Kenneth Katzman.

<sup>5</sup> "U.S. Pushes for Tighter United Nations Sanctions Against Iran," *The Oil Daily*, August 7, 2008.

The six countries considered Iran's response unclear, and in August 2008, they agreed to pursue a fourth round of U.N. sanctions against Iran.<sup>6</sup>

Iran has opposed U.S. and U.N. sanctions vehemently. The country has long maintained that the purpose of its uranium enrichment program is to produce fuel for nuclear power reactors, rather than fissile material for nuclear weapons. The Iranian government asserts its right to develop nuclear energy for peaceful purposes. Iran increasingly has questioned the justification of the sanctions in light of some recent positive reports on its nuclear activities. A November 2007 U.S. National Intelligence Estimate (NIE) assessed that Iran stopped its nuclear activities for weapons proliferation in 2003.<sup>7</sup> Iran and the International Atomic Energy Agency (IAEA) agreed in August 2007 on a work program that would clarify the outstanding questions regarding Tehran's nuclear program. Iran has clarified some questions, but a May 2008 report by the IAEA raised major new questions about Iran's nuclear intentions.<sup>8</sup>

## Overview of Iran's Economy

Iran's economic growth was expected to slow in 2009, owing to the decline in international oil prices in late 2008, domestic economic mismanagement, and limited oil revenue savings to weather the recent global economic turndown. Economic growth is expected to pick up modestly in 2010.<sup>9</sup>

During the earlier part of the decade, Iran's economy experienced broad-based growth, with the annual change in real GDP peaking in FY2007 (see **Table 2**). During this period, economic growth was driven by government spending on priority sectors, expansionary monetary and fiscal economic policies, increased growth in credit, and private consumption.

Despite high international oil prices in recent years, the contribution of the oil and gas sector to economic growth has been more modest. Iran's oil economy has been faced with low levels of production and inadequate investment.<sup>10</sup> U.S. and U.N. sanctions levied against Iran, along with the poor domestic business environment, may contribute to low levels of investment.

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<sup>6</sup> Jonathan S. Landay, "U.S., 5 other nations to seek tougher sanctions against Iran," *The Anniston Star*, August 5, 2008.

<sup>7</sup> NIE, "Iran: Nuclear Intentions and Capabilities," November 2007, accessible at [http://www.dni.gov/press\\_releases/20071203\\_release.pdf](http://www.dni.gov/press_releases/20071203_release.pdf).

<sup>8</sup> IAEA, "Implementation of the NPT Safeguards Agreement and relevant provisions of Security Council 1737 (2006), 1747 (2007) and 1803 (2008) in the Islamic Republic of Iran," Report by the Director General, May 26, 2008, <http://www.iaea.org/Publications/Documents/Board/2008/gov2008-15.pdf>.

<sup>9</sup> Global Insight, "Iran Country Report," updated December 16, 2008.

<sup>10</sup> Ibid.

**Table 2. Iran's Average Annual Real GDP Growth: 2000-2010**

Fiscal Year	Average Annual Growth (%)
2000	5.1
2001	3.7
2002	7.5
2003	7.1
2004	5.1
2005	4.7
2006	5.8
2007	7.8
2008 (estimate)	6.5
2009 (forecast)	0.5
2010 (forecast)	2.9

**Source:** Economic Intelligence Unit (derived from World Bank, World Development Indicators).

In recent years, Iran's economic growth has been hampered by double-digit rates of inflation. Although high inflation is widespread among the oil-exporting countries in the Middle East and Central Asia, Iran has one of the highest.<sup>11</sup> Iran's average Consumer Price Index (CPI) inflation level was above 25% at year-end 2008. Through 2009, the CPI inflation level dropped, but remained above 13%. For 2010, budgetary constraints are expected to reduce inflation further. By some estimates, if Iran implements the recently passed subsidy reform bill, then inflation will rise again as the price of food, utilities, education, and other goods and services increases.<sup>12</sup>

Domestic factors contributing to the uptick in inflation include expansionary government economic policies and growing consumption demands. External factors include international sanctions against Iran and rising international food and energy import prices.<sup>13</sup> Inflation levels have been associated with Ahmadinejad's efforts to curb banking interest rates for loans to sub-inflation levels. The Central Bank, the Bank Markazi, has opposed these hikes.

The unemployment rate remains high, reaching an estimated 11.8% in 2008.<sup>14</sup> Some observers contend that the unemployment rate is higher than figures reported by the Iranian government. At least one-fifth of Iranians lived below the poverty line in 2002.<sup>15</sup> Iran has a young population<sup>16</sup> and each year, about 750,000 Iranians enter the labor market for the first time, placing pressure on the government to generate new jobs.<sup>17</sup> The emigration of young skilled and educated people

<sup>11</sup> IMF, "Regional Economic Outlook: Middle East and Central Asia," *World Economic and Financial Surveys*, October 2008, p. 41.

<sup>12</sup> Global Insight, "Iran Country Report," updated December 30, 2009.

<sup>13</sup> Ibid, p. 21.

<sup>14</sup> CIA, The World Factbook.

<sup>15</sup> EIU, "Iran: Country Profile 2007," p. 33.

<sup>16</sup> About 30% of the population estimated to be under age 15 and less than 5% above age 64 in 2004.

<sup>17</sup> EIU, "Iran: Country Profile 2007," p. 33.

continues to pose a problem for Iran. The IMF reported that Iran has the highest “brain drain” rate in the world.<sup>18</sup>

## Economic Policy and Reform Efforts

Over the past few decades, Iran has engaged in a series of five-year economic plans in order to shift its state-dominated economy into an economy that is market-oriented, private sector-led, and economically diversified. Reform efforts have experienced resistance from various elements of Iran’s political establishment.

Significant strides toward trade liberalization, economic diversification, and privatization took place under the Khatemi administration (1997-2005). The government introduced some structural reforms such as tax policy changes and adoption of new foreign investment laws to promote Iran’s global market integration and attract investment. Iran shifted to a unified managed float exchange rate system in March 2002.<sup>19</sup> At various times previously, Iran has had different combinations of exchange rates, including official, export, parallel market, and Tehran stock market versions. The exchange rate reform is considered to have improved Iran’s trading environment and to have enhanced public sector transparency modestly.<sup>20</sup>

President Ahmadinejad has taken a more populist approach with his economic policies, with promises of “bringing the oil money to people’s tables” when he took office in 2005. Some critics maintain that policies under President Ahmadinejad have been a major contributor to budget deficits and are ineffective tools for combating inflation, unemployment, and poverty.<sup>21</sup>

In line with Ahmadinejad’s populist agenda, fiscal policy has been expansionary. The government provides extensive public subsidies on gasoline, food, and housing. Energy subsidies alone represent about 12% of Iran’s GDP. Some observers estimate total subsidies to reach over 25% of GDP. When including implicit subsidies, the government’s spending on subsidies may be even higher. In addition to subsidies, President Ahmadinejad has provided cash handouts to the poor. Subsidies and cash handouts are considered by many to be un-targeted and ineffective at helping the poor.

In January 2010, the Parliament passed a massive overhaul of Iran’s system of state subsidies. The legislation reduces state subsidies by \$20 billion. A goal of the reforms is to reduce overconsumption. Many analysts contend that high subsidies do not give Iranians an incentive to conserve.<sup>22</sup> While many economists assert that a reduction of Iran’s subsidies are necessary for Iran’s long-term economic sustainability, there are concerns that subsidy cuts may lead to a sharp increase in inflation of basic goods and gasoline and, based on past experience, lead to political unrest. In June 2007, the government implemented a gasoline rationing system to reduce gasoline

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<sup>18</sup> Anne Penketh, “Iran enters new year in sombre mood as economic crisis bites,” *The Independent*, March 24, 2008.

<sup>19</sup> Abdelali Jbili, Vitali Kramarenko, and José Bailén, “Islamic Republic of Iran: Managing the Transition to a Market Economy,” IMF, 2007.

<sup>20</sup> EIU, “Iran rank: Macroeconomic risk,” January 22, 2008.

<sup>21</sup> Fredrik Dahl, “Iranians worry about high food prices before vote,” Reuters, March 6, 2008.

<sup>22</sup> IMF Country Report No. 07/100, “Islamic Republic of Iran: 2006 Article IV Consultation-Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Islamic Republic of Iran,” March 2007, <http://www.imf.org/external/pubs/ft/scr/2007/cr07100.pdf>.

consumption. Although this policy was extremely unpopular and even led to public riots, it resulted in a drop in gasoline consumption. Iran's supreme leader has offered support to President Ahmadinejad in his efforts to implement the subsidy reform.<sup>23</sup> However, some analysts speculate that the political unrest following the June 2009 presidential elections may compel Ahmadinejad to return to more populist policies in an effort to maintain his political base.

Monetary policy also has been expansionary under Ahmadinejad. The government has provided low-interest loans for agriculture, tourism, and industry and has instituted loan forgiveness policies. Other activities include the creation of a number of social programs to assist farmer and rural residents.<sup>24</sup> Ahmadinejad's cabinet established the \$1.3 billion Imam Reza Mehr Fund (Imam Reza Compassion Fund) to assist youth with marriage, housing, and education in 2006.<sup>25</sup> As in other Middle Eastern countries, the rising cost of marriage is financially prohibitive to many young Iranians. Interest-free loans are available to youth for marriage through the fund. Some economists contend that Ahmadinejad's efforts to lower the interest rate have led to excessive liquidity and inflation.<sup>26</sup>

The government has used oil export revenues from the Oil Stabilization Fund (OSF) to support expansionary fiscal and monetary policies. The OSF was created by the Bank Markazi, in 2001 to store surplus oil revenue and to smooth economic vulnerabilities associated with oil price fluctuations.<sup>27</sup> Iran has been drawing down on its OSF to finance discretionary spending, such as for public subsidies, cash handouts to the poor, and low-interest loans. Of primary concern to the United States and the international community is the purported use of oil export revenues to finance Iran's nuclear program and alleged support for terrorist groups. While estimates vary about the size of the OSF, many observers express concern it no longer contains sufficient funds to cushion against the global economic turndown.<sup>28</sup>

## Economic Stakeholders

Iran's economy is heavily dominated by the state, which is the recipient of revenues from crude oil exports, and quasi-state actors, such as the *bonyads* and the commercial entities of the Islamic Revolutionary Guard Corp (IRGC). Private sector activity is limited, although the government is engaged in some privatization efforts.

### Bonyads

Sometimes referred to as "Islamic conglomerates," *bonyads* (Persian for "foundation") are semi-private charitable Islamic foundations or trusts that are believed to wield enormous political and

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<sup>23</sup> Robert F. Worth, "Ayatollah Supports Bid to Sharply Cut Iran Subsidies," *The New York Times*, April 5, 2010.

<sup>24</sup> Gareth Smyth, "Middle East: Iran cuts farm lending rate in populist 'social justice' move," *Financial Times*, November 15, 2005. Najmeh Bozorgmehr and Roula Khalaf, "World News—Iran: Bank chief takes a realistic tack," *Financial Times*, March 6, 2008.

<sup>25</sup> Najmeh Bozorgmehr and Gareth Smyth, "Coping with the rising cost of marriage, Iranian-style: The new president is to set up a fund to deal with rising expectations of the good life," *Financial Times*, November 8, 2005.

<sup>26</sup> EIU, "Iran: Monetary shrinkage," April 1, 2008.

<sup>27</sup> "Iran: Ahmadinejad populism damages economy," Oxford Analytica, February 19, 2008.

<sup>28</sup> Oxford Analytica, "Prospects 2009: Iran faces economic crisis," November 18, 2008.

economic power in Iran. They were among the institutions used by the regime to help nationalize Iran's economy after the 1979 revolution. *Bonyads* report directly to the Supreme Leader and are not subject to parliamentary supervision. They do not fall under Iran's General Accounting Law and, consequently, are not subject to financial audits. Because *bonyads* are not required to disclose their financial activities, it is not known exactly the magnitude of their wealth.

The largest Iranian charitable trust is the Foundation of the Oppressed and War Veterans (*Bonyad e-Mostazafan va Janbazan*, MJF). With more than 200,000 employees and 350 subsidiaries, the MJF has an estimated value of more than \$10 billion in assets. It is the second largest commercial enterprise in Iran, following the National Iranian Oil Company.<sup>29</sup> The MJF provides financial assistance, medical care, and recreational opportunities to Iran's poor and individuals wounded or disabled from the Iran-Iraq war. Through its company affiliates, the MJF is involved in both Iran's domestic economy and foreign economies. The MJF's domestic economic scope is expansive, with affiliates involved in economic areas such as agriculture, construction, industries, mining, transportation, commerce, and tourism. Since 1991, the MJF has invested in energy, business, engineering, and agricultural activities in Europe, Russia, Asia, the Middle East, and Africa. Some allege that the MJF is used for Iranian intelligence activities for buying dual-use products for proliferation of weapons of mass destruction (WMDs).<sup>30</sup>

Many believe that *bonyads* enjoy a significant advantage over private companies. Prior to the unification of Iran's exchange rate system, the *bonyads* were able to access foreign exchange at deep discounts compared to private enterprises. Presently, *bonyad* officials have longstanding connections with politicians, and frequently get special access to credit at state-owned banks.<sup>31</sup> In addition, *bonyads* get privileges on taxation and import duties. Some critics contend that economic and political reform in Iran will not be significant unless *bonyads* are reformed. Some also contend that these entities contribute to political corruption and limit the funneling of oil wealth to the poor. Shares for many of Iran's national companies undergoing privatization are given to *bonyads*, rather than wholly private enterprises.

## **Islamic Revolutionary Guard Corps**

The Islamic Revolutionary Guard Corps (IRGC) was founded in 1979 by the Ayatollah Khomeini and is a branch of the Iranian government's military. The IRGC is comprised of five branches: the Grounds Force, Air Force, Navy, Basij militia, and Qods Force special operations.<sup>32</sup>

The Revolutionary Guard increasingly has become an important player in the Iranian economy. The IRGC's initial economic involvement consisted of postwar reconstruction activities, largely infrastructure projects. More recently, the IRGC has become involved in commercial activity in the construction, oil and gas, and telecommunications sector.<sup>33</sup> In September 2009, a financial group affiliated with the IRGC bought a 51% stake at nearly \$8 billion in Iran's largest

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<sup>29</sup> "Highlights: Iranian Bonyad Developments, 12-18 December 2009," Open Source Center.

<sup>30</sup> "Iran: Mostzafan va Janzaban Supports Veterans, Covert Activities," Open Source Center report, May 2, 2006.

<sup>31</sup> EIU, "Iran risk: Legal and regulatory risk," January 22, 2008.

<sup>32</sup> For more information on the IRGC, see Kenneth Katzman, "The Warriors of Islam: Iran's Revolutionary Guard," Westlaw Press, 1993.

<sup>33</sup> Ali Alfoneh, "How Intertwined Are the Revolutionary Guards in Iran's Economy?," American Enterprise Institute, October 22, 2007.

telecommunications operator, which had been recently privatized.<sup>34</sup> The IRGC has significant control over Iran's borders and airports. Through its powerful connections, the IRGC frequently acquires business contracts for new projects at the expense of private sector businesses. The IRGC also serves as a leading investment tool for many of Iran's leaders.

Elements of the Iranian private sector have expressed displeasure with the IRGC. Some Iranians allege that the IRGC is involved in Iran's underground economy. The IRGC is allegedly involved in smuggling alcohol and other low-level contraband into Iran. Some report that the IRGC smuggles gasoline, which is heavily subsidized in Iran, to other countries for profit.<sup>35</sup>

Some analysts believe that the Revolutionary Guard benefits from Iran's economic isolation. With foreign businesses unwilling or unable to enter into deals, the Revolutionary Guard faces less competition for acquiring new contracts. However, because the IRGC frequently does not have the technical expertise that many international companies do, the IRGC sometimes subcontracts to international companies, making a profit as an intermediary in the transaction.<sup>36</sup>

## **U.S. Action**

The United States contends that the IRGC is involved in proliferation of weapons of mass destruction (WMDs). It argues that profits generated by the Revolutionary Guard's activities in Iran's financial and commercial sectors and engineering activities fund IRGC's illicit activities. Under Executive Order (E.O.) 13382, the United States can sanction entities for proliferation concerns. The sanctions prohibit all transactions between U.S. persons and the sanctioned entity and freeze any assets that the sanctioned entity has in the United States.<sup>37</sup>

On October 25, 2007, under E.O. 13382, the U.S. Department of State designated the IRGC for proliferation concerns. The U.S. embargo on the IRGC represented the first time that the United States has sanctioned a foreign country's military. Also on the same day and under the same executive order, the U.S. Treasury identified nine companies either owned or controlled by the IRGC and five individuals associated with the IRGC for proliferation concerns.<sup>38</sup> These companies all are reportedly tied to Iran's energy sector.<sup>39</sup> They are listed below:

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<sup>34</sup> Oxford Analytica, "Iran: Hard right strengthens its economic control," September 28, 2009. Scott Peterson, "Iran's Revolutionary Guard tightens grip," *The Christian Science Monitor*, December 6, 2009.

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

<sup>37</sup> E.O. 13382, "Blocking Property of Weapons of Mass Destruction Proliferators and Their Supporters," June 28, 2005.

<sup>38</sup> Treasury press release, "Statement by Secretary Paulson on Iran Designations," October 25, 2007, <http://www.treas.gov/press/releases/hp645.htm>. Treasury press release, "Factsheet: Designation of Iranian Entities and Individuals for Proliferation Activities and Support for Terrorism," October 25, 2007, <http://www.treas.gov/press/releases/hp644.htm>.

<sup>39</sup> "U.S. dilemma: Targeting Iran's oil industry could hurt Iran more," *International Herald Tribune*, November 5, 2007.

Companies:

- Khatam al-Anbya Construction Headquarters: Main engineering headquarters of the IRGC; secured deals of at least \$7 billion in oil, gas, transportation, and other sectors<sup>40</sup>; owned or controlled by the IRGC
- Oriental Oil Kish: Drilling company; owned or controlled by the IRGC
- Ghorb Nooh: Owned or controlled by the IRGC
- Sahel Consultant Engineering: Owned or controlled by the IRGC
- Sepasad Engineering Company: Owned or controlled by the IRGC
- Omran Sahel: Owned or controlled by the IRGC
- Hara Company: Engineering firm associated with Khatam al-Anbya; owned or controlled by the IRGC
- Gharagahe Sazandegi Ghaem: Business services company owned or controlled by the IRGC

Individuals:

- General Hosein Salimi: Commander of the Air Force, IRGC
- Brigadier General Morteza Rezaie: Deputy Commander, IRGC
- Vice Admiral Ali Akhbar Ahmadian: Former Chief of the IRGC Joint Staff
- Brigadier General Mohammad Hejazi: Former Commander of Bassij resistance force
- Brigadier General Qasem Soleimani: Commander of the Qods Force

Treasury took further action against the IRGC under E.O. 13382 on February 10, 2010. It designated IRGC General Rostam Qasemi, who also is the commander of Khatam al-Anbiya Construction Headquarters, the engineering wing of the IRGC. Treasury also designated four subsidiaries companies that are owned or controlled by Khatam al-Anbiya (designated under E.O. 13382 on October 25, 2007), or that operate on its behalf. These four companies support mining and engineering projects. They are:

- Fater Engineering Institute
- Imensazen Consultant Engineers (ICEI)
- Makin Institute
- Rahab Institute<sup>41</sup>

In addition to WMD proliferation concerns, the United States asserts that the Revolutionary Guard is involved in terrorist activities. E.O. 13224 permits the President to freeze the assets of

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<sup>40</sup> Treasury press release, “Factsheet: Designation of Iranian Entities and Individuals for Proliferation Activities and Support for Terrorism,” October 25, 2007, <http://www.treas.gov/press/releases/hp644.htm>.

<sup>41</sup> Treasury press release, “Treasury Targets Iran’s Islamic Revolutionary Guard Corps,” February 10, 2010, <http://www.ustreas.gov/press/releases/tg539.htm>.

terrorists and their supporters.<sup>42</sup> On October 25, 2007, the United States sanctioned the IRGC-Qods Force under E.O. 133224. The United States asserts that the Qods Force provides to Hezbollah's military and terrorist activities, with assistance ranging between \$100 to \$200 million a year.<sup>43</sup>

## Private Sector

Prior to the 1979 revolution, Iran boasted a vibrant, significant private sector. However, under the leadership of the Ayatollah Khomeini, the bulk of private sector companies, including commercial banks, were taken over by state and quasi-state institutions. Foreign participation in Iran's economy was prohibited.

Currently, wholly private enterprises are present in agriculture, trade, small-scale manufacturing, and mining, but play a minimal role in large-scale economic activity. In an effort toward more private sector development, Iran began a major privatization initiative in July 2006. It allowed issuances of up to 80% of shares in strategic industries through the stock market, including downstream oil sector businesses, banks, insurance, utilities, and transportation.<sup>44</sup> Iran is also working to privatize state-run oil and gas companies.

However, some members of the private sector are skeptical of the government's privatization efforts. They perceive the privatization efforts as a mechanism for redistributing assets to other parts of the state, namely the IRGC, or for the expansion of quasi-governmental actors, such as the *bonyads*.<sup>45</sup>

Iran's private sector competes with the businesses operated by the *bonyads* and the IRGC, which enjoy significant advantages over private companies. Some observers are critical of the Iranian government's continued strong involvement in the country's economy. Some Iranians believe that the government needs to invest oil export revenues in Iran's private sector rather than spending revenues on imports<sup>46</sup> and socially minded programs. In addition, the private sector is critical of the government's use of assets in the OSF to fund state-run companies at the expense of loans to private businesses.<sup>47</sup>

Historically, Iran has been a society of trade merchants, the *bazaar* class. As manufacturing in Iran is limited, merchants import goods, mark up the goods for profit, and then sell. In order to be economically viable, the *bazaar*s need low employment costs, low rents, free trade, and low regulation. The *bazaar*s tend to be skeptical of a large government role in the economy. They are supportive of Iranian trade with foreign countries. However, they tend to be critical of foreign investment because it would open up their companies to foreign competition.<sup>48</sup>

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<sup>42</sup> E.O. 13224, "Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit, or Support Terrorism," September 23, 2001.

<sup>43</sup> Treasury press release, "Factsheet: Designation of Iranian Entities and Individuals for Proliferation Activities and Support for Terrorism," October 25, 2007, <http://www.treas.gov/press/releases/hp644.htm>.

<sup>44</sup> Ibid.

<sup>45</sup> Angus McDowall, "Iran's sell-off goes full circle," *Euromoney*, September 1, 2009.

<sup>46</sup> Ibid.

<sup>47</sup> Global Insight, "Iran Country Analysis," updated July 10, 2008.

<sup>48</sup> Kenneth Katzman, Specialist in Middle Eastern Affairs, Congressional Research Service, Joint Economic Committee (continued...)

The merchant class has particularly been hurt by the international sanctions. Iranian businessmen reportedly have increased difficulty opening bank accounts abroad and getting foreign banks to honor letters of credit. According to Iranian officials, over half of the banks in Dubai no longer provide credit to businesses based in Iran.<sup>49</sup> As Iranian businesses experience setbacks in obtaining trade financing from international banking partners, they may turn to lesser known banks or to other banking partners not susceptible to international pressure, but potentially raising the cost of business. In particular, the Islamic Republic has turned toward banks in Gulf Cooperation Council (GCC) countries.

## Economic Sectors

Iran's economy has a number of key sectors. In 2008, industry – which includes oil and gas, petrochemicals, steel, textile, and automotive manufacturing – accounted for an estimated 45% of the Iran's GDP. The services sector, including financial services, represented about 44% of Iran's economy. Agriculture constituted about 11% of Iran's economy.<sup>50</sup> Agriculture continues to be one of the economy's largest employers, representing one-fifth of all jobs based on a 1991 census.<sup>51</sup> Some analysts have expressed concern that excessive focus on the oil and gas sector is crowding out investment and expansion opportunities in other sectors and opportunities for economic diversification.<sup>52</sup> Iran's economic sectors remain heavily dominated by the state, but there are some privatization efforts under way.

### **Oil and Natural Gas**

Holding an estimated 10% of global proven oil reserves, Iran boasts the world's third largest proven petroleum reserves following Saudi Arabia and Canada. Most of Iran's crude oil reserves are in the southwestern region near the Iraqi border. Among the Organization of the Petroleum Exporting Countries (OPEC) members, Iran is the second largest oil producer following Saudi Arabia. In 2008, Iran produced about 3.8 million barrels of crude oil per day. While oil export revenues have grown in past years due to surges in oil prices, Iran's crude oil output has remained essentially flat.

Iran' oil production levels are limited by a number of factors. The oil industry faces a high rate of natural decline of mature oil fields and low oil recovery rates. It is believed that millions of barrels of oil are lost annually because of damage to reservoirs and these natural declines. Iran also has been plagued by aging infrastructure and old technology. Structural upgrades and access to new technologies, such as natural gas injections and other enhanced oil recovery efforts, have been limited by a lack of investment partly due to U.S. sanctions.<sup>53</sup> U.S. companies are restricted by U.S. law from investing in Iran's oil development, but firms from other countries, until recently, have actively invested in Iran's oil sector development.

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(...continued)

Hearing on Iran, July 25, 2006.

<sup>49</sup> Anna Fifield, "No problem," *Financial Times*, April 14, 2008.

<sup>50</sup> CIA, The World Factbook.

<sup>51</sup> EIU, "Country Profile 2007: Iran," 2007, p. 27.

<sup>52</sup> Ibid, pp. 26-27.

<sup>53</sup> EIA, "Country Analysis Briefs: Iran," updated January 2010.

Under Iran's fifth five-year development plan (2010-2015), if approved by the *Majlis*, Iran would invest \$200 billion to increase oil and gas production. According to the plan, more than 40 oil fields would be developed to boost oil production capacity to five million barrels of oil per day by 2014. Gas production capacity would be boosted from 552 million cubic meters in 2008 to 996 million cubic meters in 2013. According to estimates, about \$125 billion in foreign investment would be needed for the plan. Another \$45 billion to \$50 billion in investment would be derived from domestic sources.<sup>54</sup>

Iran has the second largest natural gas reserves globally, following Russia.<sup>55</sup> Despite its vast gas resources, Iran was a net importer of natural gas as late as 2005. Natural gas production could be used for domestic consumption, exports to European and Asian markets, and development of Iran's petrochemicals industry.<sup>56</sup> Iran has sought international investment to help build its natural gas sector. However, U.S. sanctions have limited Iran's access to technologies from abroad that are necessary for developing liquefied natural gas plants.<sup>57</sup>

The oil and gas sector is heavily state-dominated. Iran is engaging in efforts to privatize nearly 50 state-run oil and gas companies, estimated to be worth \$90 billion, by 2014 through the Tehran Stock Exchange. Both domestic and foreign investors would be able to buy shares. Privatization of these energy companies may make it easier for investors to circumvent U.S. sanctions, which complicate investors' ability to engage in business transactions with Iran directly.<sup>58</sup> The Iranian Oil Minister has announced that a privately-owned bank with a minimum capital of \$200 million is expected to open soon to fund oil industry projects.<sup>59</sup>

## Agriculture

Iran is a major world provider source of caviar and pistachio nuts, a significant non-oil export for Iran. The country's climate and terrain also support tobacco, tea, wheat and barley, among other food commodities. Iran's agriculture production is vulnerable to periodic droughts, including a severe drought in 2008. In addition to climate change, the agricultural sector faced setbacks in production during the 1979 revolution and the war with Iraq.<sup>60</sup> Overfishing and environmental degradation also threaten the agriculture sector.

Iran typically has used oil export revenues to pay for agricultural imports. However, rising international food commodity prices combined with a large population increase have placed pressure on Iran's economy, despite high international oil prices. Other Middle Eastern countries are experiencing similar economic strains.<sup>61</sup>

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<sup>54</sup> Aresu Eqbali, "Iran unconcerned by US gasoline sanctions," *Platts Oilgram Price Report*, March 16, 2010.

<sup>55</sup> EIA, "Country Analysis Briefs: Iran," updated January 2010.

<sup>56</sup> EIU, "Country Profile 2007: Iran," 2007, p. 42.

<sup>57</sup> Samuel Ciszuk, "Tightened Iran Sanctions Introduced by UN Security Council in Anticipation of IAEA Report," February 22, 2008.

<sup>58</sup> "Tehran opens energy sector to overseas investment," *Middle East Economic Digest*, February 8, 2008.

<sup>59</sup> "Iran to establish private oil bank," *Trend News Agency*, April 19, 2010.

<sup>60</sup> EIU, "Country Profile 2007: Iran," 2007, pp. 35-36.

<sup>61</sup> Javier Blas, "Mideast reels as hunger outgrows oil earnings," *Financial Times*, May 7, 2008.

## Manufacturing

Iran is working to build up various industries within its manufacturing sector, including steel, automotives, food products, and petrochemicals. There is some concern that Iran's manufacturing sector has declined because oil export revenues have increased Iran's exchange rate, making the manufacturing sector less competitive.<sup>62</sup> Manufacturing activity reportedly has been impeded by international sanctions. Iranian manufacturing units rely on imported parts and services from Europe. Access to imported intermediate goods has been complicated because a number of European banks have scaled down financial transactions with Iranian businesses.<sup>63</sup>

## Steel

Iran is the largest producer of steel in the Middle East<sup>64</sup> and a significant producer of steel globally. Despite Iran's high production levels, the country is a net importer of steel.<sup>65</sup> There has been a ramp-up of growth in demand for steel in the Middle East, fueled by the need for investments in energy project infrastructure and expansion of construction activity. The Iranian Privatization Organization has announced plans to privatize a number of steel companies in FY2010.<sup>66</sup>

## Automotives

In 2008, Iran was the 14<sup>th</sup> largest motor vehicle producer in the world, with production increasing by 5.4% from the previous year. Iran produces both light and heavy vehicles.<sup>67</sup> Its two biggest automakers are Iran Khodro and Saipa.<sup>68</sup> Auto plants frequently have outdated technology and parts must be imported through third countries. Cars frequently are not fuel-efficient, contributing to pollution.<sup>69</sup> Despite Iran's high level of automotive production, domestic demand for motor vehicles exceeds supply. Iran imports a variety of vehicles, including basic models, luxury vehicles, and vehicles for construction and mining. Iran reduced the tariff rate on auto imports in 2006. The Iranian Privatization Organization has announced plans to offer shares of both Iran Khodro and Saipa to the public by June 20, 2010.<sup>70</sup>

Iran has begun joint ventures with foreign companies for auto production, including Peugeot and Citroen (France), Volkswagen (Germany), Nissan and Toyota (Japan), Kia Motors (South Korea),

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<sup>62</sup> "Economy & Dutch Disease," *Iran Daily, Islamic Republic News Agency*, April 24, 2007. Lionel Beehner, "What Sanctions Mean for Iran's Economy," Council on Foreign Relations, May 5, 2006.

<sup>63</sup> Global Insights, "Iran Country Analysis," updated July 10, 2008.

<sup>64</sup> EIU, "Country Profile 2007: Iran," 2007, p. 45.

<sup>65</sup> World Steel Association, "World Steel in Figures 2009," 2008 <http://www.worldsteel.org/>.

<sup>66</sup> "Iran plans to privatise mine and steel companies," *Steel Business Briefing*, April 13, 2010.

<sup>67</sup> Ranking based on CRS comparison of International Organization of Motor Vehicles (OICA) correspondents survey, "World Motor Vehicle Production by Country and Type: 2007-2008," <http://oica.net/category/production-statistics/>.

<sup>68</sup> Eric Ellis, "Made in Iran," *Fortune Magazine*, September 12, 2006.

<sup>69</sup> Ibid.

<sup>70</sup> "Iran: Iran Khodro, Saipa to be privatized: official," *Plus News Pakistan*, April 12, 2010.

Proton (Malaysia), and Chery (China).<sup>71</sup> Foreign companies have entered the Iranian auto market with some caution in light of concerns about U.S. reaction and reputational risks.

Based on perceived reputational risks, the German automaker Daimler has restricted its business activity in Iran. Daimler has sold its 30% stake in a subsidiary of Iran Khodro and has withdrawn an application to export commercial vehicles to Iran, but will fulfill existing contracts.<sup>72</sup>

## **Food Products**

There has been a rise in agriculture-related manufacturing, such as rice milling and manufacturing of canned food and concentrates, fruit juices, and confectionary. Foreign companies, such as Nestle, Coca Cola, and Pepsi have signed deals for production with local Iranian businesses.<sup>73</sup> Under U.S. sanctions regulations, foreign subsidiaries of American companies are able to trade or engage in business in Iran.

## **Petrochemicals**

Iran is the second largest manufacturer of petrochemicals in the Middle East, following Saudi Arabia. About half of Iran's petrochemical product sales are for its domestic market.<sup>74</sup> In an attempt to diversify its exports, Iran is building up its petrochemicals industry.<sup>75</sup> The industry reportedly faces some challenges from state intervention and price-fixing. Additionally, international sanctions have reduced commercial banks' willingness to finance international deals to build the petrochemical sector.<sup>76</sup>

## **Financial Sector**

Iran's financial sector has been heavily dominated by large, public banks since the nationalization of the banking system after the 1979 revolution. Over the past couple of decades, Iran has engaged in some privatization and liberalization of its financial sector. In 2001, Iran's Central Bank approved licenses for three full functioning private banks. Efforts toward privatization have been thwarted frequently by the Guardian Council.

Iran's Central Bank technically is an independent institution. However, the Iranian government has direct control over lending and investment activities of commercial banks. Bank Markazi is not able to conduct a "proactive" monetary policy and has no control over the government's fiscal policy. It is limited in its ability to issue direct instruments to combat inflationary pressures. The Central Bank must obtain approval from the *Majlis* in order to issue participation papers.<sup>77</sup>

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<sup>71</sup> EIU, "Country Profile 2007: Iran," 2007, p. 45. Prime Vista Research and Consulting, "Automotive Industry and Marketing of Iran 2007," June 2007.

<sup>72</sup> Global Insights, "Iran: Daimler Becomes Latest Company to Curtail Ties to Iran," April 15, 2010.

<sup>73</sup> EIU, "Country Profile 2007: Iran," 2007, p. 46.

<sup>74</sup> Global Insights, "Iran Country Analysis," updated July 10, 2008.

<sup>75</sup> EIU, "Country Profile 2007: Iran," 2007, p. 44.

<sup>76</sup> "Iran Petrochemicals Report Q1 2008," *Business Monitor International*, February 20, 2008.

<sup>77</sup> EIU, "Iran Economy: Quick View—Monetary Strife—Country Briefing," ViewsWire, April 21, 2008.

State-owned banks are considered by many to be poorly functioning as financial intermediaries. Private banks are hampered by extensive regulations and the government's populist policies, including administrative controls on rates of return and subsidized credit for specific regions of the country. Setting interest rates below the rate of inflation reportedly has placed many commercial banks under financial duress.<sup>78</sup>

In addition, most of the financial intermediaries' loan portfolios are comprised of low-return loans to state-owned enterprises and quasi-government agencies, such as the *bonyads*. By IMF estimates, non-performing loans have amounted to more than one-fifth of Iranian banks' loan portfolios, which is close to five times the average of emerging markets as a whole. The bulk of the non-performing loans are in economic sectors in which the Iranian government is involved in directed lending. These sectors include manufacturing, mining, agriculture, and trade.<sup>79</sup>

Some believe that the financial system has stifled domestic business and has lowered Iran's attractiveness to foreign businesses.

## **Tehran Stock Exchange**

In 1967, Iran began operating the Tehran Stock Exchange (TSE). With initially six companies, the TSE now lists over 300 companies. Capitalization through the TSE is permitted for the automotive, mining, petrochemical, and financial sectors. Since 2005, foreign investors have been able to participate in the TSE. Foreign investors are permitted to hold a maximum of 25% of shares of each company listed, up from 10% previously. However, foreign activity in the TSE is low, estimated to account for less than 2% of investment in the TSE.<sup>80</sup> Aside from concerns about the international tensions associated with Iran's nuclear standoff, low foreign activity may also reflect concerns about liquidity, transparency, and the poor legal environment protecting foreign holdings.<sup>81</sup>

Between July 2008 and April 2009, the TSE fell by 38%, with investor confidence shaken by the global economic turndown and the impact of declining oil prices on Iran's economy.<sup>82</sup> However, by the end of 2009, the TSE had risen by 58%. The fluctuations in the TSE are consistent with trends in the Gulf countries and global markets.

## **Financial Sanctions**

The U.S. Department of the Treasury has employed targeted financial measures against Iran. The United States is attempting to isolate Iran from the international financial and commercial system in an effort to promote policy change in Iran regarding its nuclear program and purported terror financing. The United States also hopes that financial isolation will limit Iran's resources for its nuclear program and its alleged support for terrorist organizations. In congressional testimony, the Treasury Deputy Assistant Secretary for Terrorist Financing and Financial Crimes in 2008 stated,

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<sup>78</sup> Ibid.

<sup>79</sup> Global Insight, Country Intelligence—Analysis, "Iran: Article IV Report on Iran Highlights Deteriorating Economic Activity and Need for Reform," March 26, 2010.

<sup>80</sup> Global Insight, "Iran Country Analysis," updated December 30, 2009.

<sup>81</sup> Ibid.

<sup>82</sup> Global Insight Daily Analysis, "Iran's Bourse Pummeled by Worrying Economic News," December 16, 2008.

“Iran utilizes the international financial system as a vehicle to fund these terrorist organizations... the Iranian regime operates as the central banker of terrorism, spending hundreds of millions of dollars each year to fund terrorism.”<sup>83</sup>

Several major Iranian banks are under U.S. and U.N. sanctions. Under E.O. 13224,<sup>84</sup> the Treasury has designated several Iranian entities for supporting terrorism. On October 25, 2007, the Treasury designated Bank Saderat, a major Iranian state-owned financial institution, for terrorism support. Iranian authorities contend that two external audits of Bank Saderat conducted in Lebanon and London found no evidence of such allegations.<sup>85</sup>

Treasury also has designated a number of financial institutions under E.O. 13382<sup>86</sup> for assisting with Iran’s missile program. The following lists some of the institutions sanctioned under E.O. 13382:

- On January 9, 2007, the Treasury sanctioned Bank Sepah, a major Iranian financial enterprise.<sup>87</sup> U.N. Security Council Resolution 1747 named Bank Sepah and Bank Sepah International as financial institutions involved in financing nuclear or ballistic missile activities.
- On October 25, 2007, the Treasury Department sanctioned Bank Melli and Bank Mellat, other major Iranian financial institutions, as WMD proliferators or supporters.<sup>88</sup> In June 2008, the European Union also decided to sanction Bank Melli.
- On March 12, 2008, Treasury sanctioned the Bahraini Future Bank B.S.C. in March 2008 for reportedly assisting in Iran’s nuclear and missile programs. The United States contends that Future Bank B.S.C. is controlled by the embargoed Bank Melli.<sup>89</sup>
- On October 22, 2008, Treasury designated the Export Development Bank of Iran (EDBI) for providing or attempting to provide financial services to Iran’s Ministry of Defense and Armed Forces Logistics (MODAFL). The EDBI is a state-owned financial institution that supports Iran’s trade community. Treasury also sanctioned three financial institutions associated with EDBI, two of which are located in Iran and one located in Venezuela.<sup>90</sup>

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<sup>83</sup> Daniel Glaser, Testimony before the House Committee on Foreign Affairs Subcommittee on the Middle East and South Asia and the Subcommittee on Terrorism, Nonproliferation, and Trade, April 17, 2008, HP-933.

<sup>84</sup> E.O. 13224, “Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit, or Support Terrorism,” September 23, 2001.

<sup>85</sup> IMF, “Islamic Republic of Iran: 2006 Article IV Consultation,” IMF Country Report No. 07/100, March 2007, p. 17.

<sup>86</sup> E.O. 13382, “Blocking Property of Weapons of Mass Destruction Proliferators and Their Supporters,” June 28, 2005.

<sup>87</sup> Treasury press release, “Iran’s Bank Sepah Designated By Treasury,” January 9, 2007, <http://www.treas.gov/press/releases/hp219.htm>.

<sup>88</sup> Treasury press release, “Statement by Secretary Paulson on Iran Designations,” October 25, 2007, <http://www.treas.gov/press/releases/hp645.htm>. Treasury press release, “Factsheet: Designation of Iranian Entities and Individuals for Proliferation Activities and Support for Terrorism,” October 25, 2007, <http://www.treas.gov/press/releases/hp644.htm>.

<sup>89</sup> Treasury press release, “Treasury Designates Iran-Controlled Bank for Proliferation: Future Bank Controlled by Iran’s Bank Melli,” March 12, 2008, <http://www.treas.gov/press/releases/hp869.htm>.

<sup>90</sup> Treasury press release, “Export Development Bank of Iran Designated as Proliferator,” October 22, 2008, <http://www.ustreas.gov/press/releases/hp1231.htm>.

- On November 5, 2009, Treasury sanctioned First East Export Bank (FEEB), a subsidiary of Bank Mellat located in Malaysia. The United States asserts that FEEB is owned or controlled by Bank Mellat.<sup>91</sup>

In a move to further restrict Iran's access to the U.S. financial system, the Treasury revoked the "U-turn" license for U.S. financial institutions on November 6, 2008.<sup>92</sup> With respect to Iran, "U-turn" fund transfers are financial transactions that pass through the U.S. financial system only en route from one offshore non-Iranian financial institution for another, conducted for the direct or indirect benefit of the Iranian government, banks, or individuals. Previously, U.S. financial institutions were allowed to process such financial transactions.

The United States and some European countries assert that certain Iranian banks and their branches are attempting to circumvent international financial sanctions in order to engage in proliferation-related activity and terrorist financing. Iranian government officials have denied these claims.<sup>93</sup>

Financial sanctions reportedly have affected the profitability of Iranian banks and damaged Iran's credit ratings. Financial intermediaries have faced challenges financing development projects, such as building oil infrastructure.<sup>94</sup> Iran is taking steps to protect its foreign assets from future international sanctions. For instance, Iran reportedly has started shifting billions of dollars from European banks to Iranian and Asian banks and purchasing gold and equities. However, some economists express concern that Asian banks may not be reliable because of their close relationship to Europe's economy.<sup>95</sup>

## **Money Laundering**

Iran's financial system may be vulnerable to money laundering. Since 2002, the Central Bank of Iran has engaged in efforts to combat money laundering. In January 2008, Iran passed its first anti-money laundering law, which criminalized money laundering. Critics contend that Iran's money laundering framework may contain vulnerabilities that pose a threat to the international financial system. On December 5, 2009, Iran adopted implementing regulations for the Anti-Money Laundering (AML) law. Iran continues to work to bring its AML framework in line with international standards.<sup>96</sup>

On March 3, 2008, the U.S. Treasury's Financial Crime Enforcement Network (FinCEN) issued a statement emphasizing concern about ongoing deficiencies in Iran's efforts to combat money laundering and the financing of terrorism through its financial system. The U.S. Treasury advisory stated that, using state-owned banks, Iran "disguises its involvement in proliferation and terrorism activities through an array of deceptive practices specifically designed to evade detection." Of particular concern to the U.S. Treasury is that Iran's central bank and commercial

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<sup>91</sup> Treasury press release, "Treasury Designates Bank Mellat Subsidiary and Chairman Under Proliferation Authority," November 5, 2009, <http://www.ustreas.gov/press/releases/tg355.htm>.

<sup>92</sup> Treasury press release, "Fact Sheet: Treasury Strengthens Preventative Measures Against Iran," November 6, 2008, <http://www.treas.gov/press/releases/hp1258.htm>.

<sup>93</sup> "Iran: Iran Dismisses US Allegations against Banks as Ridiculous," *Thai News Service*, August 18, 2008.

<sup>94</sup> "Investment shortfall 'threatens Iran oil output,'" *AFX Asia*, July 9, 2007.

<sup>95</sup> Steven Lee Myers and Nazila Fathi, "European Leaders Back Bush on Iran," *The New York Times*, June 11, 2008.

<sup>96</sup> IMF, "Islamic Republic of Iran: 2009 Article IV Consultation," IMF Country Report No. 19/74, March 2010, p. 12.

banks have requested their names to be removed from international transactions in order to make it more difficult to track their involvement.

The Treasury advisory noted 59 major Iranian banks or their branches in international financial cities that pose threats, including Iran's central bank. None of the banks listed currently face U.N. or U.S. sanctions.<sup>97</sup> The advisory encouraged all financial institutions to consider the risks associated with doing business with the specified Iranian financial institutions.<sup>98</sup> Additionally, the Financial Action Task Force (FATF), a Paris-based "international financial watchdog," called on its 34 member states to encourage banks to monitor their financial interactions with Iran. The FATF alleges that Iran has not taken adequate actions to combat money laundering and terror financing.<sup>99</sup> Iranian officials assert that the Bank Markazi complies with international best practices and that it vigilantly regulates domestic financial institutions.

### **Informal Financial Sector**

Many Iranian businesses and individuals rely on *hawala*, an informal trust-based money transfer system that exists in the Middle East and other Muslim countries. *Hawala* transactions are based on an honor system, with no promissory instruments exchanged between the parties and no records of the transactions. Some analysts consider the *hawala* system as particularly susceptible to terrorist financial transactions.

Since the imposition of recent U.S. and U.N. financial sanctions on Iran, the use of *hawala* by Iranians reportedly has increased. It is considered by many Iranians to be a more cost-effective way to transfer money in light of the added expenses incurred through working through the formal financial system in light of the sanctions. According to a Iranian merchant, "If we wanted to send money through the banking system it would cost a small fortune, so we move money to dealers and they send the money through Dubai to China." While some assert that the use of *hawala* shows that Iran is able to circumvent international sanctions successfully, others suggest that the increased use of *hawala* is a sign of the sanctions' effectiveness in making it more difficult for Iran to finance transactions.<sup>100</sup>

## **International Trade**

International trade contributes significantly to the Iranian economy. Between 2004 to 2007, Iran's total trade in goods (exports plus imports) nearly doubled, reaching about \$147 billion in 2007. Due to the decline in international oil prices, Iran's trade surplus dropped from \$32 billion 2008

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<sup>97</sup> Robin Wright, "Iran a Nuclear Threat, Bush Insists; Experts Say President Is Wrong and Is Escalating Tensions," *The Washington Post*, March 22, 2008.

<sup>98</sup> Daniel Dombey and Stephani Kirchgaessner, "Steer clear of Iran central bank, says US," *Financial Times*, March 21, 2008. Jeannine Aversa, "Treasury warns banks that Iran is engaging in deceptive practices to skirt sanctions," Associated Press, March 20, 2008.

<sup>99</sup> Jeannine Aversa, "Treasury warns banks that Iran is engaging in deceptive practices to skirt sanctions," Associated Press, March 20, 2008.

<sup>100</sup> Anna Fifield, "No problem," *Financial Times*, April 14, 2008.

to \$17 billion in 2009 (see **Table 3**). Some analysts point out that Iran's trade with the world may actually be higher due to transshipment or black market trade.<sup>101</sup>

Iran maintained a current account surplus in 2008. The current account surplus declined from 12% of GDP in 2007 to 7% of GDP in 2008.<sup>102</sup>

A rebound in oil prices in 2010 would boost Iran's export growth, contributing to an improvement in Iran's trade balance and current account balance. However, such improvement may be constrained somewhat by higher import prices due to sanctions. According to the Iran's Trade Commission, international financial sanctions have raised trade costs for Iran between 5% and 10% annually and have increased the time it takes to conduct transactions.<sup>103</sup>

**Table 3. Iran Merchandise Trade, 2006-2008**  
(millions of U.S. dollars)

Merchandise	2006	2007	2008 <sup>a</sup>	2009 <sup>b</sup>
Exports	76,055	97,401	100,572	77,408
Oil and gas	62,011	81,764	81,855	59,240
Non-oil and gas	14,044	15,637	18,717	18,168
Imports	50,020	56,582	68,533	60,327
Trade Balance	26,035	40,819	32,039	17,081
Total Trade	126,075	153,983	169,105	137,735

**Sources:** IMF, "Islamic Republic of Iran: 2008 Article IV Consultation," August 2008, IMF Country Report No. 08/284. IMF, "Islamic Republic of Iran: 2006 Article IV Consultation," March 2007, IMF Country Report No. 07/100.

Notes:

- a. Data for 2008 are estimated.
- b. Data for 2009 are projected.

## Major Goods Traded

Oil and gas exports are Iran's most important export. Other major export commodities are petrochemicals, carpets, and fresh and dried fruits. Top destinations for Iran's non-oil exports are the United Arab Emirates (UAE), Iraq, China, Japan, and India.

Major imports for Iran include gasoline and other refined petroleum products, industrial raw materials and intermediate goods used as manufacturing inputs, capital goods, food products, and other consumer goods.

<sup>101</sup> Global Insight, "Iran Country Analysis," updated December 30, 2009.

<sup>102</sup> IMF, "Islamic Republic of Iran: 2009 Article IV Consultation," March 2010, IMF Country Report No. 10/74.

<sup>103</sup> Global Insight, "Iran Country Analysis," updated December 30, 2009.

## **Oil Exports**

Iran remains the fourth largest exporter of crude oil worldwide, after Saudi Arabia, Russia, and the UAE.<sup>104</sup> In 2008, Iran exported 2.5 million barrels of oil per day. Iran's net revenues from oil exports totaled \$73 billion in that year.<sup>105</sup>

Iran exports primarily to Asian countries and European countries that are a part of the OECD. Top export markets for Iran are Japan, China, India, South Korea, and Italy. More than 40% of the world's oil traded goes through the Strait of Hormuz, a channel along Iran's border. The Strait of Hormuz is considered a global "chokepoint" because of its importance to global energy security. It is a narrow channel with a width of only 21 miles at its widest point through which large volumes of oil are shipped.<sup>106</sup>

Oil revenue accounts for the majority of export earnings (about 80%) and represents the bulk of government revenue (about 40%). They are the most important source of foreign exchange earnings for the country. Iran's dependence on oil export revenues makes the country highly susceptible to the volatility of international oil prices. The quadrupling of global oil prices since 2002 cushioned the extent to which Iran's economy may have been affected by international sanctions and its alleged domestic policy mismanagement. However, the recent decline in oil prices may highlight weaknesses in Iran's economy.

There is debate about the extent to which declines in oil prices may affect Iran's economy. Oil price declines would reduce government revenue and spending and potentially increase Iran's vulnerability to sanctions. Oil price drops also would affect the private sector, as Iran imports a significant portion of its capital and machinery goods from abroad. A fall in oil prices and subsequent economic downturn may increase political dissent among Iranians, already facing high unemployment and inflation levels.

## **Refined Petroleum Imports**

Despite Iran's vast oil reserves, the country must import close to half of all the refined petroleum products it needs to meet domestic consumption requirements. In 2009, Iran gasoline imports totaled about 130,000 barrels of oil per day, close to 80% of all of Iran's total imports of products.<sup>107</sup>

In 2009, Iran's gasoline suppliers included Vitol (Switzerland), Glencore (Switzerland), Trafigura (Switzerland), China National Petroleum Corporation (CNPC), Independent Petroleum Group (IPG, Kuwait), Litasco (Russia), Petronas (Malaysia), Reliance Industries Limited (RIL, India), Royal Dutch Shell, Total (France), and Zhenua Oil (China).<sup>108</sup> In addition, Venezuela supplies small quantities of gasoline from time to time in a show of political solidarity with Iran. Iran and

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<sup>104</sup> Ibid.

<sup>105</sup> EIA, "Country Analysis Briefs: Iran," updated January 2010

<sup>106</sup> Ibid.

<sup>106</sup> Energy Information Administration (EIA), "World Transit Oil Chokepoints," January 2008.

<sup>107</sup> EIA, "Country Analysis Briefs: Iran," updated January 2010

<sup>108</sup> Energy Information Administration (EIA), "Country Analysis Briefs: Iran," updated January 2010. EIA data sourced from Argus, FACTS, *Oil Daily*, and *Petroleum Intelligence Weekly*.

Venezuela have sought to counter U.S. global influence and strengthen their own international standing and reputation through strategic alliances.<sup>109</sup>

In recent years, many of the world's biggest oil traders have terminated gasoline supplies to Iran. What follows are some recent developments:

- The Swiss-based wholesalers Vitol, Glencore, and Trafigura have been long-standing suppliers of gasoline to Iran. While they reportedly sold gasoline to Iran in 2009, these companies have since stopped shipments due to the mounting political and commercial risks of doing business with Iran.<sup>110</sup> The termination of shipments follows a trend in recent years of scaling back business with Iran. For instance, in December 2007, Vitol reportedly declined to renew long-term contracts with Iran, but still provides gasoline to Iran on the spot market.
- India's Reliance has been a major supplier of gasoline to Iran. However, in January 2009, Reliance reportedly agreed to terminate gasoline sales to Iran once its current contractual obligations expire.<sup>111</sup> Previously, some Members of Congress called on the U.S. Export-Import Bank to rescind two loan guarantees worth \$900 million authorized to RIL, in support of the RIL's petroleum refinery equipment and services (\$500 million) and for gas development and exploration in India's Bay of Bengal region (\$400 million).<sup>112</sup>
- In the first half of 2010, Malaysia's Petronas, Russia's LUKOIL, and Royal Dutch Shell reportedly stopped selling gasoline to Iran.<sup>113</sup>

Iran's longtime suppliers of gasoline from Europe are being succeeded by smaller Dubai-based and Chinese companies.<sup>114</sup> China's ZhenHua Oil, which began selling gasoline to Iran in 2009, reportedly now provides Iran with one-third of its gasoline imports.<sup>115</sup>

A number of factors contribute to Iran's high gasoline consumption rates. Many analysts contend that high energy subsidies do not give Iranians an incentive to conserve. In addition, there has been an increase in vehicle sales, particularly of fuel-inefficient older models. Import levels are also high because Iran has limited domestic refinery capacity to produce light fuels.<sup>116</sup> Some analysts predict that Iran could become a net export of gasoline by 2013 if the government achieves its targets for domestic gasoline refinery projects and eliminates gasoline subsidies. Oil consumption also is declining as consumers are moving more toward natural gas use.

In recent months, there have been reports that Iran has been increasing strategic reserves of gasoline. Analysts have noted a rise in Iran's gasoline imports, which likely is accounted for by

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<sup>109</sup> Power and Interest News Report (PINR), "Iran Looks for Allies through Asian and Latin American Partnerships," May 27, 2007.

<sup>110</sup> Javier Blas, "Oil traders end petrol supplies to Iran as US pressure pays off," *Financial Times*, March 8, 2010.

<sup>111</sup> "Reports of Indian Company's Decision to Halt Gas Shipments to Iran Welcomed by Sherman," International Trade Daily, January 8, 2009. "Rep. Sherman Issues Statement on Reported RIL Decision to Stop Selling Refined Petroleum to Iran," US Fed News Service, January 7, 2009.

<sup>112</sup> Export-Import Bank of the United States, *Annual Report 2008* and *Annual Report 2007*, Washington, DC.

<sup>113</sup> "Petronas halts fuel sales to Iran as sanctions loom," *Reuters News*, April 15, 2010.

<sup>114</sup> Javier Blas, "Oil traders end petrol supplies to Iran as US pressure pays off," *Financial Times*, March 8, 2010.

<sup>115</sup> Javier Blas, "Oil traders end petrol supplies to Iran as US pressure pays off," *Financial Times*, March 8, 2010.

<sup>116</sup> Energy Information Administration (EIA), "Country Analysis Briefs: Iran," October 2007.

Iran's attempt to build up its strategic reserves. Iranian authorities may be trying to cushion the country against a possible formal international embargo of gasoline exports to Iran. Even without the passage of formal sanctions, a number of gasoline suppliers have limited their business activities with Iran due to political and diplomatic pressure.<sup>117</sup>

## Trading Relationships

In 2009, Iran's top overall trading partner was China. Iran's next largest trading partner was Japan, followed by the United Arab Emirates, India, and Korea. Significant export markets for Iran included China, Japan, India, and Turkey. Major merchandise suppliers for Iran included China, Germany, the UAE, and South Korea (see **Table 4**).

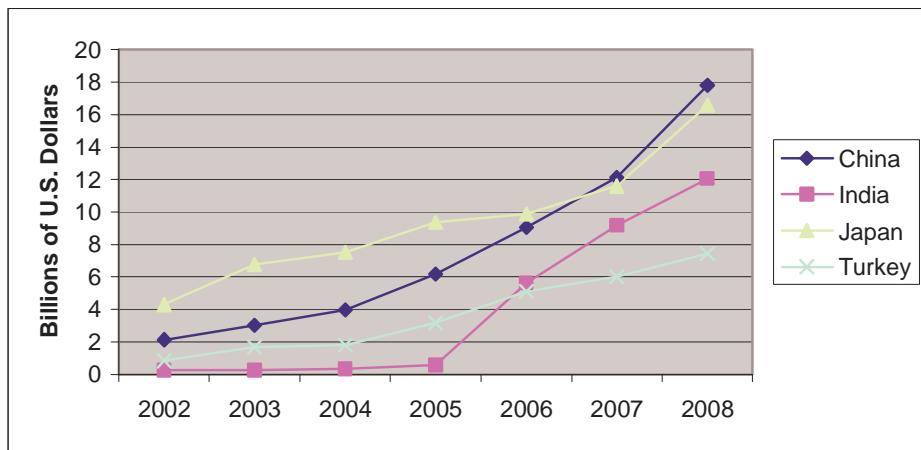
**Table 4. Major Export Markets and Sources of Imports for Iran, 2009**  
(millions of U.S. dollars)

Country	Total Trade	Exports	Imports	Trade Balance
Argentina	1,197	7	1,190	-1,183
Brazil	1,264	17	1,247	-1,230
China	26,653	17,801	8,852	8,949
Taiwan	5,201	4,581	620	3,961
France	6,070	3,167	2,903	264
Germany	7,002	704	6,298	-5,594
India	13,941	12,061	1,880	10,181
Italy	8,775	5,269	3,506	1,763
Japan	18,687	16,587	2,100	14,487
Korea	12,253	7,476	4,777	2,699
Russia	4,032	364	3,668	-3,304
Singapore	1,923	1,450	473	977
Spain	4,822	4,069	753	3,316
South Africa	3,569	3,394	175	3,219
Turkey	9,687	7,454	2,233	5,221
UAE	14,177	978	13,199	-12,221

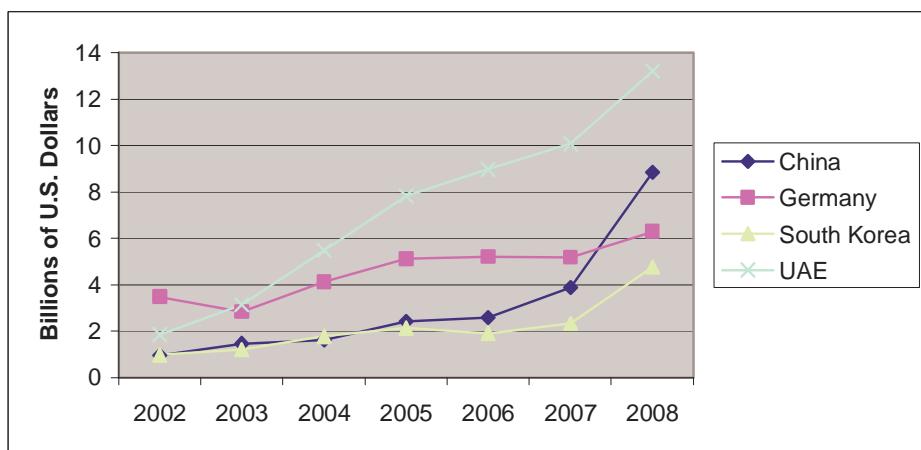
**Source:** IMF, *Direction of Trade Statistics*

Iran's trading relations have changed over time as international concern over Iran's nuclear program has affected economic activity. Iran's trade has shifted from Western countries to the developing world. **Figure 1** and **Figure 2** highlight trends in Iran's trading relationships.

<sup>117</sup> Global Insight, Country Intelligence—Analysis, “Iran: Iran Builds Gasoline Stockpiles as Sanctions Threat Looms.”

**Figure 1. Iran's Exports to Select Countries, 2002-2008**

**Source:** IMF, *Direction of Trade Statistics*

**Figure 2. Iran's Imports From Select Countries, 2002-2008**

**Source:** IMF, *Direction of Trade Statistics*

## Europe

A number of European countries, most notably Germany, historically have had important trade ties with Iran. Germany remains Iran's top trading partner in Europe. However, Germany's importance as a trading partner for Iran has declined in recent years. Germany has come under pressure from the United States to curtail trade with Iran.

German export credits backing trade with Iran totaled about \$186 million in 2008, about one-fourth of the value of German export credits for Iran in 2007 and one-tenth that in 2005.<sup>118</sup> In addition to a decline in export credits, the repayment terms for export credits reportedly have been shortened. Iranian companies seeking to import from Germany can no longer receive export

<sup>118</sup> Judy Dempsey, "As pressure builds for tougher Iran sanctions, Germany firms pull back: Tehran's nuclear program complicates business for a major trading partner," *International Herald Tribune*, February 4, 2010.

credit guarantees for seven to ten years, typical for large-scale infrastructure projects. Rather, they must repay the loans within 360 days.<sup>119</sup> Germany has been conducting extra scrutiny of export authorizations requests and evaluating the financial risks of doing business with Iran more closely.<sup>120</sup> Despite the scaling back of German official export credits for trade with Iran, German exports to Iran increased by about 22% from 2007 to 2008, while German imports from Iran increased by about 3%.<sup>121</sup>

Some large European financial institutions have reduced businesses with sanctioned Iranian bodies. For instance, Germany's Commerzbank and Deutsche Bank, have reduced or stopped business with Iran. The United Kingdom's HSBC and Standard Chartered also have lowered business with Iran.<sup>122</sup> Many European banks that have curtailed business with Iran are leaving offices open on a minimal basis in case there is a change in the international climate towards Iran.<sup>123</sup>

In February 2010, two of Germany's largest insurance companies, Allianz and Munich Re, announced that they would curb their business operations in Iran due to Iran's "political situation." Both companies have said that they would not write any new policies tied to Iran or renew existing contracts after their expire.<sup>124</sup> In addition, Germany's Siemens recently announced it was reducing business in Iran.<sup>125</sup>

## **Asia**

Facing challenges in trading with Western countries, Iran has sought to strengthen ties with Asian countries. Between 2002 and 2008, total trade between Iran and China grew nearly eight-fold. China has surpassed Germany as Iran's biggest trading partner. It is the largest destination for Iran's exports and the biggest source of Iran's imports. Iran benefits from low-cost imports from China. Major Chinese exports to Iran include mechanical and electrical equipment and arms. Iran's growing trade relationship with China also may be rooted in strategic reasons, such as China's position as one of five permanent UNSC members.<sup>126</sup>

## **Middle East**

Iran also has pursued increased integration with its neighbors in the Middle East. Iran's trade with Middle Eastern partners accounted for 6% of its total trade with the world in 2002. By 2008, this figure had increased to nearly 13%. The Iran Customs Administration cites Iraq, the UAE, and

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<sup>119</sup> Judy Dempsey, "In Response to Iran's Nuclear Program, German Firms are Slowly Pulling Out," *The New York Times*.

<sup>120</sup> Bertrand Benoit, "Berlin hardens trade stance with Iran," *Financial Times*, February 11, 2008.

<sup>121</sup> CRS calculations based on IMF, *Direction of Trade Statistics*.

<sup>122</sup> "German imports from Iran up despite nuclear row-paper," *Reuters News*, January 8, 2008.

<sup>123</sup> Samuel Ciszuk, "UN Security Council Tightens Iran Sanctions, Complicating Oil and Gas Developments and Trade," Global Insight Daily Analysis, March 4, 2008.

<sup>124</sup> Global Insight, Country Intelligence—Analysis, "Iran: World's Largest Re-Insurer Pulls out of Iran," February 22, 2010.

<sup>125</sup> Judy Dempsey, "As pressure builds for tougher Iran sanctions, Germany firms pull back: Tehran's nuclear program complicates business for a major trading partner," *International Herald Tribune*, February 4, 2010.

<sup>126</sup> Global Insight, "Iran Country Report," updated July 10, 2008.

Afghanistan as destinations for Iranian exports of natural gas condensates, industrial and agricultural products, minerals, carpets, handicrafts, and petrochemicals.<sup>127</sup> Arab nations may be weary of Iran's nuclear ambitions, but they appear to value trade and investment relations with Iran. Many are hoping that positive economic engagement with Iran will mitigate international tensions over Iran's nuclear ambitions.

The UAE, in particular, is a major trading partner for Iran, with trade largely dominated by UAE exports to Iran. The bulk of merchandise supplied to Iran by the UAE is believed to be products imported into the UAE from foreign markets and subsequently repackaged for shipment to Iran.

The UAE thrives as a central re-exporting and distribution center in the Persian Gulf because of its low tax rates, free trade zones, lower delivery times, enhanced handling and service capacity, and a perception of lax export controls. Dubai, in particular, is Iran's economic lifeline to the rest of the world. Through Dubai, Iran is able to import goods that the country cannot import directly due to international and U.S. sanctions. Although U.S. businesses are outlawed from operating in Iran, many reportedly can circumvent U.S. sanctions by sending their investments through Dubai.

The United States has called on the UAE to make its export controls more stringent. In recent months, the UAE appears to be taking actions to regulate trade and investment relations with Iran in a more stringent manner. In September 2007, the UAE passed a law permitting it to place restrictions on dual-use technologies, chemical and biological weaponry, and military equipment. The UAE used the new law for the first time to impound a vessel at Jebel Ali that was delivering merchandise to be transshipped to Iran.<sup>128</sup> About 40 Iranian companies were closed in 2007 based on UAE efforts to reduce trade in goods with potential "dual use."<sup>129</sup>

Financial institutions in the UAE reportedly are restricting Iran's access to credit, making it harder for Iranian businesses to trade goods with the UAE. Some UAE banks reportedly have frozen the assets of Iranian firms and have reduced opening letters of credits to Iranian businesses. UAE-based banks may be wary of reputational and financial risks associated with such transactions. Consequently, some Iranian businesses have had to shift to other regional banks or have had to engage in cash-based transactions, raising the costs of goods on the end-user. Dubai continues to be an important transshipment hub for Iran, but some parts of the Iranian business community are concerned about the potential implications of a more stringent UAE approach to commercial ties with Iran. There is a possibility that trade diversion to Iran may take place through other countries if the UAE is perceived as a hostile business environment.<sup>130</sup>

## **United States**

U.S. trade with Iran is limited, receding drastically with the 1987 U.S. ban on imports from Iran and the 1995 ban on U.S. exports to and investments in Iran. Before 1995, major U.S. exports to Iran included machinery and industrial equipment. U.S. exports virtually came to a standstill with the 1995 embargo on U.S. trade and new investment in Iran. Sanctions were relaxed to a certain extent in 2000, with the election of President Khatami in Iran. While U.S. trade with Iran is low

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<sup>127</sup> "Iran: Boost in Iran's exports," *Plus News Pakistan*, November 14, 2009.

<sup>128</sup> Barbara Surk, "Dubai at center of US efforts to pressure Iran," *Associated Press Newswires*, October 26, 2007.

<sup>129</sup> "UAE/Iran: Trade squeeze, or business as usual?", EIU—Business Middle East, January 16, 2008.

<sup>130</sup> Global Insight, Country Intelligence—Analysis, "U.A.E. Banks Latest to Restrict Iran's Access to Credit," October 28, 2008.

compared to U.S. trade with other countries, there has been notable growth in U.S.-Iranian trade in recent years (see **Table 5**).

Top U.S. exports to Iran include soybeans, pharmaceutical preparations, wheat, wood pulp, and medical equipment. Major U.S. imports from Iran include textile and floor coverings; artwork, stamps, and collectibles; fruits and related products; nuts and related products; and vegetables and related products.<sup>131</sup> There is evidence that Iran is able to obtain embargoed U.S. goods through the re-export trade, mainly through Dubai.<sup>132</sup>

**Table 5. U.S.-Iranian Trade, 2000-2009**  
(Millions of U.S. Dollars)

Year	U.S. Exports	U.S. Imports	Balance
2000	17	169	-152
2001	7	143	-136
2002	32	156	-124
2003	99	161	-62
2004	85	152	-67
2005	96	175	-79
2006	86	157	-79
2007	145	173	-28
2008	683	104	581
2009	282	67	215

**Source:** U.S. Census Bureau, Foreign Trade Statistics

U.S. sanctions against Iran may curtail U.S. economic activity, imposing costs on American workers and businesses and reducing U.S. exports.<sup>133</sup> U.S. businesses have expressed concerns about U.S. measures against companies that are unable to control re-exports of high-technology goods to Iran and other targeted countries. Others have noted that U.S. policies in Iran may deprive the United States of significant business opportunities in Iran. Europe, China, India, and Russia are stepping in and taking advantage of Iran's sizeable market and untapped potential. Proponents of sanctions contend that the security, reputational, and financial risks associated with doing business with Iran outweigh the economic benefits.

In general, entities targeted by U.S. sanctions do little business with the United States. Consequently, the United States depends on other countries to reduce trade and investment with Iran in an effort to change Iran's policies. Such sanctions would have little effect on U.S.-Iran

<sup>131</sup> Jospeh J. Schatz, "On Iran Sanctions, a Delicate Lobbying Task," *Congressional Quarterly Daily*, April 22, 2010.

<sup>132</sup> GAO-08-58, "Iran Sanctions: Impact in Furthering U.S. Objectives Is Unclear and Should Be Reviewed," p. 18, December 2007.

<sup>133</sup> Jeffrey J. Schott, "The Iran and Libya Sanctions Act of 1996: Results to Date," Peterson Institute for International Economics, Testimony before the Committee on International Relations, U.S. House of Representatives, July 23, 1997.

trade since such trade is already limited. However, the action would send a strong signal to foreign countries and may hurt Iran's trade with major trading partners.<sup>134</sup>

## Trade Liberalization

In 1995, Iran became a WTO observer state and, since then, has repeatedly put forth applications to become a permanent WTO member. Accession to the WTO is a stated priority of the Iranian government. Iran cites the more favorable treatment that WTO members give to one another and competition from Asian countries in textiles and manufactures as important challenges to Iranian exports.<sup>135</sup> The United States repeatedly blocked Iran's bids to join the WTO over concerns about Iran's nuclear program and support for terrorist activities. On the other hand, many European Union countries and developing countries have supported Iran's accession. Iran and many other countries maintain that WTO membership should not be based on political reasons, but rather, on economic and business grounds.<sup>136</sup>

In a significant policy shift toward Iran in May 2005, the United States agreed to stop blocking Iran's attempts to join the WTO as part of economic incentives to Iran to resolve the nuclear program issue. However, the most recent negotiations for accession have ceased because of political reasons and Iran continues to not be a member of the WTO.<sup>137</sup> The WTO accession process is lengthy and some Iranians have expressed concern that domestic momentum for the reforms necessary for accession has waned. Iran, along with Russia, now remain the two largest economies outside of the WTO.

## International Financial Flows

### Foreign Exchange Reserves

Iran's foreign exchange reserves, which include the Oil Stabilization Fund, tend to follow international oil prices. Based on IMF estimates, Iran's international reserves grew from \$60.5 billion in FY2006 to \$82.9 billion in FY2007.<sup>138</sup> For FY2008, Iran's international reserves was estimated to total \$79.6 billion.<sup>139</sup> Owing to the recent drop in oil prices, Iran's international reserves may shrink. There is concern that domestic economic mismanagement has reduced funds available through the OSF to smooth economic vulnerabilities facing Iran in the present global economic environment.

The composition of Iran's foreign reserves has changed lately. In December 2007, Iran stopped accepting payments in U.S. dollars for oil export purchases by foreign countries and is shifting to

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<sup>134</sup> Glenn R. Simpson, "Democrats Urge Sanctions on Iran's Central Bank," *The Wall Street Journal*, March 5, 2008.

<sup>135</sup> IMF, "Islamic Republic of Iran: 2006 Article IV Consultation," IMF Country Report No. 07/100, March 2007, p. 18.

<sup>136</sup> Fiona Fleck, "Iraq Is Granted Observer Status at the WTO," *The New York Times*, February 12, 2004.

<sup>137</sup> IMF, "Islamic Republic of Iran: 2006 Article IV Consultation," IMF Country Report No. 07/100, March 2007, p. 18.

<sup>138</sup> IMF, "Islamic Republic of Iran: 2006 Article IV Consultation," IMF Country Report No. 08/284, August 2008.

<sup>139</sup> Global Insights, "Iran Country Analysis," updated March 30, 2009.

other currencies, such as the euro and the yen. Iran also called upon other OPEC members to shift away from the dollar in favor of other currencies during a November 2007 OPEC summit. Aside from Venezuela, all other member states opposed the switch.<sup>140</sup> The Central Bank also is reducing the proportion of dollars in its foreign reserves and diversifying to other currencies.<sup>141</sup>

## Foreign Investment in Iran's Economy

As the most populous country in the Middle East and with vast natural resources, Iran potentially has a significant market for foreign businesses. However, foreign direct investment (FDI) in Iran historically has been low relative to other countries in the region due to a combination of political and structural factors (see **Table 6**).

**Table 6. Foreign Investment Flows in Iran and Selected Other Countries**

Billions of U.S. Dollars

Country	2006	2007	2008
Iran	1.6	1.7	1.5
Egypt	10.0	11.6	9.5
Turkey	20.2	22.0	18.2
Saudi Arabia	18.3	24.3	38.2

**Source:** United Nations Conference on Trade and Development (UNCTAD), Foreign Direct Investment online data base.

A stringent domestic regulatory environment and government reluctance to allow foreign investment have contributed to low levels of FDI. For instance, in the energy sector, foreign investment is believed to be limited due to Iran's buy-back system. Under this system, international oil companies that contract with an Iranian affiliate pay a fee—such as an “entitlement to oil or gas from development operation.” In 2006, buybacks were projected to reach \$500 million.<sup>142</sup>

Elements of the Iranian establishment have resisted foreign investment. Iranian officials have encouraged foreign companies to enter into the Iranian market. However, many business contracts have been won by quasi-state actors, such as the *bonyads* and commercial entities of the IRGC.

International sanctions and political uncertainty have clouded Iran's economy and have made some foreign business and investors wary about economic involvement in Iran. U.N. and some U.S. sanctions are targeted toward obstructing Iran's development of its oil and gas sectors in order to constrain Iran's resources for uranium enrichment and alleged terrorist financing.<sup>143</sup> Foreign companies have had difficulty obtaining financing due to U.S. Treasury Department

<sup>140</sup> “Iran stops accepting U.S. dollars for oil,” RIA Novosti, December 8, 2007.

<sup>141</sup> Najmeh Bozorgmehr and Roula Khalaf, “World News—Iran: Bank chief takes a realistic tack,” *Financial Times*, March 6, 2008.

<sup>142</sup> IMF, “Islamic Republic of Iran: 2006 Article IV Consultation,” IMF Country Report No. 07/100, March 2007, p. 29.

<sup>143</sup> See CRS Report RS20871, *Iran Sanctions*, by Kenneth Katzman.

pressure on international banks to cut off ties with Iran.<sup>144</sup> Foreign companies also have limited investment in order to avoid U.S. opposition and to maintain good relations with the United States. International investors reportedly have withdrawn from development projects in Iran, such as in the oil and gas, shipping, and automotive industries.<sup>145</sup> Iran faces a problem of significant domestic capital flight abroad.<sup>146</sup> For instance, Iranian investors have found more profitable opportunities for property investment overseas, such as in the UAE.

International energy companies that have decided to suspend development projects in Iran include British Petroleum, Total, Royal Dutch Shell, Repsol YPF, StatoilHydro, and Eni. Some companies have decided to continue current projects, but to not engage in any future projects with Iran for the time being.<sup>147</sup> As some European companies have scaled down energy sector development projects, other European partners are stepping in (see **Table 7** for selected recent deals negotiated by Iran).

With Western involvement in Iran's energy sector tenuous, Iran has been turning toward Asian countries, such as China and Pakistan; Russia and Central Asian countries; and regional partners, such as Bahrain and Turkey. While new agreements have been negotiated, their successful completion has been slow. Many speculate that the deals are not finalized because of international concerns over Iran's nuclear enrichment program and the specter of sanctions.<sup>148</sup> According to a GAO report, State and Treasury officials assert that U.S. sanctions have contributed to a delay in foreign investment in Iran's hydrocarbon sector.<sup>149</sup> The Iranian government contends that sanctions and international pressure have not slowed down foreign investment in Iran's gas sector.

**Table 7. Selected International Energy Deals Negotiated by Iran**

Country	Notes
Switzerland	Swiss energy company EGL signed a 25-year LNG export deal with the National Iranian Gas Export Company (NIGC) in March 2007, reportedly valued at €18 billion. Switzerland will buy 5.5 billion cubic meters of Iranian natural gas each year, beginning in 2011. This would be Europe's second largest gas deal. <sup>150</sup> There is some skepticism that Iran will not be able to supply gas to Switzerland for the foreseeable future because no pipeline connects Iran to Europe at present. The State Department is evaluating the deal for possible violations of the Iran Sanctions Act.
Austria	Austrian partially state-owned energy company OMV signed letters of intent with Iran in April 2007 for Iran to supply Europe with gas, transactions reportedly valued at \$23 billion. The State Department is evaluating the deal for possible violations of the Iran Sanctions Act.
Russia	In February 2008, Russian state gas company Gazprom announced a deal to establish a joint venture company to develop the offshore Iranian South Pars gas field. Iran would benefit from a build-up of its gas export infrastructure. <sup>151</sup>
China	A China National Offshore Oil Corporation (CNOOC) investment deal, reportedly valued at \$16

<sup>144</sup> "Iran economy: Oil breakthrough?," Economist Intelligence Unit, December 10, 2007.

<sup>145</sup> Global Insight, "Iran Country Report," updated July 10, 2008.

<sup>146</sup> Oxford Analytica, "Iran: Economy to weather crisis, sanctions, populism," August 14, 2009.

<sup>147</sup> BMI Industry Insights, "StatoilHydro Pulling Out of Iran, But Pulling In The Profits," August 1, 2008.

<sup>148</sup> "Iran: Sanctions and threats damage economy," Oxford Analytica, June 15, 2007.

<sup>149</sup> GAO-08-58, "Iran Sanctions: Impact in Furthering U.S. Objectives Is Unclear and Should Be Reviewed," p. 18, December 2007.

<sup>150</sup> Benjamin Weinthal, "Switzerland to sign second-largest Iran gas deal today," *The Jerusalem Post*, March 17, 2008.

<sup>151</sup> "Gazprom announces gas deals with Iran and Nigeria," *Energy Economist*, March 1, 2008.

Country	Notes
	billion, to develop Iran's North Pars gas field and to build a liquid natural gas (LNG) plant, was supposed to be signed on February 27, 2008 but has been delayed. Some analysts believe that China has been hesitant to finalize the deal because of international reaction to Iran's nuclear program and the tightening of United Nations sanctions. The state-operated National Iranian Oil Company (NIOC) and CNOOC signed a memorandum of understanding in December 2006 for the project, under which CNOOC would purchase 10 million metric tons per year of LNG for 25 years. <sup>152</sup> The United States has criticized China's pursuit of the deal with Iran. China has also looked into alternate suppliers, such as Qatar and Australia. <sup>153</sup>
Pakistan	NIGC is expected to finalize a natural gas export deal with Pakistan in April 2008, reportedly valued at \$7.4 billion. Exports are set to begin in 2011. The gas would be transported through a "Peace Pipeline." The plan initially also included exporting gas to India, but negotiations have stalled over pricing. The United States has strongly opposed the pipeline and pressured India and Pakistan to halt the project.
Turkey	Iran is discussing gas production and export deals with Turkey. Under the plans, Turkey would assist in developing Iran's South Pars field in exchange for cash or natural gas. Gas would be shipped from Iran to Turkey and then to other parts of the world, including Europe, via a new pipeline that Turkey plans to build. <sup>154</sup>
Germany	In November 2008, the German company Steiner recently announced plans to build three LNG plants in Iran, reportedly valued at \$147 million. <sup>155</sup> While there has been some international criticism of this decision, German authorities point out that the deal did not violate export controls of sensitive goods. <sup>156</sup> Iranian officials assert that it will continue to develop Iran's gas fields, even with foreigners pulling out investment.
Malaysia	In December 2008, Iran signed gas deals reportedly valued at \$14 billion with Malaysia's SKS Group. The deal included a contract to build an LNG plant. <sup>157</sup>
Bahrain	In December 2008, Iran and Bahrain drafted an agreement on the delivery of 1 billion cubic feet per day of natural to Bahrain. <sup>158</sup>
Russia	In March 2009, Gazprom, a Russian conglomerate, and the National Iranian Oil Company (NIOC) reportedly concluded a hydrocarbon swap agreement under which Gazprom agreed to deliver gas from Turkmenistan to Iran in exchange for gas and petroleum products from Iran. <sup>159</sup>
India	In December 2009, India announced that its Oil and Natural Gas Corporation (ONGC) and partner companies plan to invest about \$10 billion in developing Iran's South Pars gasfield and a LNG facility, intended to deliver South Pars gas for export. <sup>160</sup>

(...continued)

<sup>152</sup> "Chinese delegation to sign major gas deal soon: source," *Platts Commodity News*, March 5, 2008.

<sup>153</sup> David Winning and Renya Peng, "Update: CNOOC, Iran to Ink Deal for 10 Mln Tons LNG-Sources," *Dow Jones Newswires*, January 21, 2008.

<sup>154</sup> "Iran, Turkey to Discuss Gas Projects," *Turkish Daily News*, May 5, 2008. "Iran-Turkey Deals Could Prove Key to Europe's Gas Import Plans," *International Oil Daily*, December 1, 2008.

<sup>155</sup> Rikard Jozwiak, "EU exports to Iran rise," *European Voice*, July 8, 2008.

<sup>156</sup> "EU exports to Iran rising despite sanctions," *Reuters EU Highlights*, August 6, 2008.

<sup>157</sup> "Iran/Turkey: Iran, Turkey Plan to Set up Gas Company," *Thai News Service*, December 29, 2008.

<sup>158</sup> Oxford Analytica, "Gas deal points to Bahraini confidence," Global Strategic Analysis, Monday 8, 2008.

<sup>159</sup> Oxford Analytica, "Russia/Iran: Swap agreement bolsters energy ties," April 8, 2009.

<sup>160</sup> Oxford Analytica, "India: Energy firms agree to invest in Iran," December 3, 2009.

## **International Loans and Assistance**

### **World Bank**

Iran receives loans from the World Bank. As of February 25, 2010, the net principle amount of World Bank loans totaled Iran \$3.1 billion, of which \$2.7 billion had been disbursed.<sup>161</sup> Currently, the World Bank has two active portfolios in Iran, focused on the environment and poverty alleviation. The World Bank's activity in Iran restarted in 2000, following a seven year halt. World Bank loans to Iran come only from the International Bank for Reconstruction and Development (IBRD), the Bank's market-rate lending facility.

Iran is unable to borrow from the Bank's International Development Agency (IDA), a concessional lending and grant-making fund, because of its per capita GDP. The United States has not made any contributions to the IBRD, which lends to Iran, since 1996. Some lawmakers call for reducing U.S. contributions to the IDA in protest of IBRD lending to Iran. However, some question the merits of penalizing other countries that receive loans from the IDA.

In addition, the World Bank's International Finance Corporation (IFC) has invested in Iran, providing a \$5 million joint venture among a Iranian private bank, a French bank, and the IFC. Iran also has joined the World Bank's Multilateral Investment Guarantee Agency (MIGA), which offers political risk insurance to foreign and domestic investors in Iran.<sup>162</sup>

### **Bilateral Official Development Assistance**

In terms of bilateral official development assistance (ODA), major donor countries to Iran are Germany, France, the Netherlands, Norway, and Japan. Total ODA given by countries of the Organization for Economic Cooperation and Development (OECD) to Iran amounted to \$63 million in 2008 (see **Table 8**).

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<sup>161</sup> World Bank data accessed April 19, 2010.

<sup>162</sup> For more information on World Bank lending to Iran, see CRS Report RS22704, *The World Bank and Iran*, by Martin A. Weiss and Jonathan E. Sanford.

**Table 8. Net ODA to Iran from OECD DAC Members, 2002-2008**  
 (millions of U.S. dollars)

Donor	2002	2003	2004	2005	2006	2007	2008
Austria	3.4	5.7	6.4	4.4	3.4	4.2	4.8
Germany	31.8	38.8	41.2	40.6	38.4	42.3	42.7
France	7.9	9.5	15.7	14.8	15.4	18.1	15.6
Japan	17.5	11.3	19.8	-2.5 <sup>a</sup>	-7.4 <sup>a</sup>	-12.1 <sup>a</sup>	-16.7 <sup>a</sup>
Netherlands	3.8	7.7	11.1	6.8	1.0	2.2	4.5
Norway	5.3	9.7	11.5	4.3	2.6	0.1	1.3
United States	0.2	0.5	4.8	3.8	2.3	2.2	2.7
Total DAC Countries <sup>b</sup>	81.5	102.1	138.9	78.2	70.7	67.3	63.1

**Source:** OECD, "Geographical Distribution of Financial Flows to Developing Countries: Disbursements, Commitments, and Country Indicators," multiple years.

- a. Negative grants may be due to the return to the owner of unspent balances that were previously disbursed as grants.
- b. OECD DAC members for which data is reported are Australia, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

On the whole, the United States does not provide foreign assistance, but does provide some humanitarian assistance, to Iran. For instance, the U.S. Agency for International Development (AID) has provided disaster relief assistance following the earthquake that struck near the Iranian city of Bam on December 26, 2003.

## Congressional Issues and Options

Members of Congress appear to be divided about the United States' course of action with respect to Iran. Some contend that the United States should pursue harsher measures against Iran, given the gravity of the real and potential threats posed by Iran's uranium enrichment program and terrorism financing. Others suggest that perhaps the United States should consider more positive engagement with Iran through rebuilding diplomatic ties and pursuing economic engagement with Iran, such as through Iran's accession to the World Trade Organization. They suggest that Iran would be receptive to sincere positive engagement on the part of the United States.

## Unilateral and Multilateral Approaches to Sanctions

There is debate about whether or not the United States should pursue more sanctions against Iran unilaterally or through U.N. action. Some lawmakers assert that U.S. unilateral efforts to pressure Iran may detract from building multilateral consensus to widen punitive measures against Iran.

through the United Nations. Some maintain that unilateral efforts also might reduce Iran's willingness to cooperate with the United Nations.<sup>163</sup>

Others note that pursuing multilateral action can be a lengthy process and that it is difficult to find consensus among foreign countries with various competing interests, such as security and commercial interests. The United Nations successfully passed the third round of sanctions against Iran only after watering them down to satisfy Chinese and Indian concerns. As industrializing countries with increasing energy demands and insufficient supplies, China and India view Iran as a critical energy supplier for their needs. Both countries also have growing trade relations with Iran. Such national interest priorities may override international security concerns about Iranian alleged terrorist financing or nuclear technology development. Still, some lawmakers consider the recently-passed third U.N. resolution a good first step and support pushing for more punitive action through the UNSC. Others suggest that the extent to which China and India engage in economic transactions with Iran may be muted somewhat by the two countries' ties with the United States.

## **Impact of Sanctions on Iran's Economy and Policy**

Analysts debate the impact of sanctions on Iran's economy. International tensions associated with Iran's nuclear program and alleged financing for terrorist organizations undoubtedly have complicated Iran's business environment. Some analysts point to Iran's low levels of foreign investment, difficulties obtaining trade finance, and challenges in developing its oil and gas sectors as evidence of the impact of sanctions.

On the other hand, according to a GAO report, "Iran's global trade ties and leading role in energy production make it difficult for the United States to isolate Iran and pressure it to reduce proliferation activities and support for terrorism." The Peterson Institute for International Economics (IIE) writes that sanctions increasingly have been unsuccessful as globalization has allowed embargoed countries to find other suppliers and export destinations for trade and investment.<sup>164</sup> Sanctions may not raise the costs to the point that they are crippling to the Iranian's trade and financial interactions with the rest of the world. Iran reportedly is able to circumvent the trade ban by transshipment of U.S. exports through other countries, such as the UAE. Analysts also note that international sanctions may simply result in a diversion of Iran's trade to other countries that do not enforce sanctions against Iran.

In addition to the impact of sanctions on Iran's economy, some lawmakers question the effectiveness of sanctions, noting that despite decades of sanctions, the United States has not been able to significantly shift the Iranian government's policies. Previous studies have found that sanctions have little impact on government policy and that, rather, they tend to hurt the population of a country. In congressional testimony, one observer stated, "In a broader sense, sanctions often end up hurting ordinary people while having little impact on the government leaders we are trying to influence."<sup>165</sup> The recent enforcement of targeted financial measures appears to signal an effort

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<sup>163</sup> Jay Solomon, "U.S. Sanctions Bahrain Bank Over Iran," *The Wall Street Journal*, March 13, 2008.

<sup>164</sup> Jeffrey J. Schott, "The Iran and Libya Sanctions Act of 1996: Results to Date," Peterson Institute of International Economics, Testimony before the Committee on International Relations, U.S. House of Representatives, July 23, 1997.

<sup>165</sup> William A. Reinsch, President of National Foreign Trade Council and Co-Chairman of USA\*Engage, Testimony before the U.S. Senate Committee on Finance, Regarding S. 970, The Iran Counter-Proliferation Act of 2007," April 8, 2008.

to avoid the drawbacks of the broader trade sanctions of the past and to concentrate pressure on certain key actors. Despite the narrower focus of targeted financial sanctions, the effects of these sanctions may spill over to the Iranian populace. There is uncertainty about how sanctions affect the elite, and how elite views may spillover into government policy.<sup>166</sup>

Congress may choose to follow with GAO's assessment and require the U.S. Treasury and State to collect data to assess the economic impact of sanctions on Iran. According to a recent GAO report, U.S. economic sanctions on Iran have had affected Iran, but the extent of these effects on Iran's economy and the government's decisions are difficult to gauge. The GAO notes that assessment of the impact of sanctions is challenging because of a lack of data collection by the U.S. government and baseline information for comparability.<sup>167</sup>

## Action in the 110<sup>th</sup> Congress

In the 110<sup>th</sup> Congress, several bills were passed in the House related to Iran. House-passed bills encouraged tighter sanctions against Iran, but noted that such action does not indicate congressional support for U.S. military action against Iran. The following were some of the major pieces of legislation proposed by lawmakers:

- H.R. 957, "To amend the Iran Sanctions Act of 1996 to expand and clarify the entities against which sanctions would be imposed," would have stiffened existing sanctions against Iran. The bill was passed by the House on July 31, 2007 and referred to Senate committee on August 3, 2007.
- H.R. 2347, "Iran Sanctions Enabling Act of 2007," and the corresponding Senate version of the bill (S. 1430) would have encouraged divestment from companies that conduct business with Iran. The Bush Administration opposed H.R. 2347 on the grounds that it may interfere with U.S. foreign policy efforts. The bill would have allowed for sanctions against countries such as China, Russia, and France for conducting business with Iran.<sup>168</sup> H.R. 2347 was passed by the House on July 31, 2007 and referred to Senate committee on August 3, 2007.
- H.R. 1400, "The Iran Counter-Proliferation Act of 2007," and its companion bill, S. 970, would have expanded economic sanctions against Iran and removed the presidential waiver in the Iran-Libya Sanctions Act. H.R. 1400 was passed by the House on September 25, 2007 and referred to Senate committee on September 26, 2007.
- H.R. 2798 was a more narrowly targeted measure against Iran. It would have prohibited any assistance by the Overseas Private Investment Corporation (OPIC) to individuals who have finance or investment ties to countries that are state sponsors of terror. The bill would have targeted Iran, North Korea, and Sudan. The bill was passed by the House on July 23, 2007 and was ordered to be

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<sup>166</sup> "Iran: Sanctions and threats damage economy," Oxford Analytica, June 15, 2007.

<sup>167</sup> GAO-08-58, "Iran Sanctions: Impact in Furthering U.S. Objectives Is Unclear and Should Be Reviewed," p. 18, December 2007.

<sup>168</sup> Adam Graham-Silverman, "Despite Flurry of Action in House, Congress Unlikely to Act Against Iran," *Congressional Quarterly Today*, September 12, 2007.

reported out to the Senate committee and placed on the Senate Legislative Calendar on March 4, 2008.

- H.R. 1357, “To require divestiture of current investments in Iran, to prohibit future investments in Iran, and to require disclosure to investors of information relating to such investments,” was referred to House subcommittee on June 5, 2007.
- H.R. 7112, “Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2008,” would have widened current sanctions to U.S. firms with foreign subsidiaries doing business in Iran; would have encouraged businesses to divest from Iran; and would have imposed penalties on countries that are involved in transshipment, re-exportation, or diversion of sensitive goods to Iran. H.R. 7112 was passed by the House on September 26, 2008 and referred to House committees. The related Senate measure, S. 3445, was introduced on September 26, 2008.

## Action in the 111<sup>th</sup> Congress

In the 111<sup>th</sup> Congress, several bills have been introduced to expand economic and diplomatic pressure on Iran.

Some lawmakers have advocated targeting Iran’s dependency on imports of refined petroleum products. H.R. 2194, the “Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2009,” was passed by the House on December 15, 2009. The bill would permit sanctions to be imposed on investments of \$20 million or more that directly and significantly contribute to the enhancement of Iran’s ability to develop Iranian petroleum resources. In addition, the bill would permit sanctions on the exportation of refined petroleum resources to Iran and activities that support the exportation of refined petroleum resources, including shipping, insurance, and financing activities. S. 2799, the Senate version of H.R. 2194, was passed by the Senate on March 11, 2010. Some Members of Congress have urged a speedy reconciliation of the two bills.

Supporters of such punitive options assert that they will place pressure on the Iranian government, given Iran’s lack of refining capacity and dependence on gasoline imports. Others fear that such action would adversely affect global energy supplies and ramp up prices for U.S. consumers.<sup>169</sup> In addition, some American business groups express concern that such measures may affect their foreign subsidiaries or partners who conduct business with Iran, raising questions about trade-offs between security and commercial interests.<sup>170</sup> Some critics also maintain that such an action would target the Iranian populace more than the regime. There is speculation about how congressional passage of such measures would affect President Obama’s efforts to secure international support for another round of U.N. sanctions.

H.R. 1327, the Iran Sanctions Enabling Act of 2009, would support recent actions taken by some state and local governments and education institutions to divest their pension funds from persons and companies that invest more than \$20 million in Iran’s energy sector. The bill would prohibit legal action against asset managers who divest and would require states to take several measures

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<sup>169</sup> Jad Mouawad, “Iran feels West’s grip; Energy troubles carry risks of protests,” *International Herald Tribune*, February 13, 2007.

<sup>170</sup> Joseph J. Schatz, “On Iran Sanctions, a Delicate Lobbying Task,” *Congressional Quarterly Today*, April 22, 2010.

when considering divestment, including providing the targeted entity with an opportunity to demonstrate that it does not have investment activities in Iran that meet the \$20 million threshold. H.R. 1327 was introduced on March 5, 2009, and a committee hearing was held on March 12, 2009. On October 15, 2009, the bill was referred to Senate committee.

Supporters of the legislation assert that a divestment policy provides the United States with significant political and financial leverage against Iran. Critics argue that a divestment strategy would hamper U.S. diplomatic negotiations with Iran. The United States also may risk trade retaliation from countries whose companies are facing divestment. Others maintain that U.S. divestment efforts may not significantly affect the financial operations of foreign companies to the extent that might prompt them to reconsider their business activities in Iran.

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